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LASALLE EXTENSION UNIVERSITY

RAILWAY REGULATION

AN ANALYSIS OF THE UNDERLYING PROBLEMS IN RAILWAY ECONOMICS FROM THE STANDPOINT OF GOVERNMENT REGULATION

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PREFACE

In the following pages an attempt is made to present an analysis of the leading problems in railway economics from the standpoint of government regulation in the United States. While it has been my purpose to vitalize the discussion by the liberal use of concrete illustrative material, the emphasis throughout has been placed upon the discovery of underlying causes and the consideration of fundamental principles.

The historical development of railway transportation has been traced only in so far as early conditions and past events have been shown to throw light upon the meaning and significance of current practices and present-day problems. The various stages in the growth of the American system of public control, state and national, have been given careful and detailed consideration because the principles and methods of railway regulation, as applied in the United States today, are the result of a gradual development. Both legislative enactment and judicial decision have slowly accommodated themselves to the irresistible pressure of our changing social and political ideals and our expanding commercial and industrial needs.

The vital and inseparable relationship, in railway transportation, between legal rules and business welfare, between railway economics and railway regulation, has served as the source and foundation of the entire analysis

and discussion. The ideal of railway regulation is to harmonize, as far as possible, the natural functioning of railway enterprise with the principles and practices of public control.

The various sources, primary and secondary, upon which chief reliance has been placed in the preparation of this text are indicated in detail in the course of the pages that follow. Special acknowledgement must here be made to Professor William Z. Ripley, of Harvard University, for his help and influence both as teacher and writer, and to the late Professor Harrison S. Smalley, of the University of Michigan, whose volume on *Transportation in the United States,* published by the LaSalle Extension University, was placed freely at my disposal. I am also indebted to Mr. Asa Colton for reading both manuscript and proof and making many helpful suggestions.

I. L. S.

Ann Arbor, Michigan,
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RAILWAY REGULATION

CHAPTER I

THE EXTENT AND IMPORTANCE OF RAILWAY TRANSPORTATION

The Extent of American Railway Interests

A discussion of the problems of railway regulation in the United States may well begin with a statement of the extent of the railway interests to be regulated. Some conception of the magnitude of these interests may be obtained by a consideration of the extent of mileage, the amount of equipment, the number of employees engaged in the service, the amount of outstanding securities representing capital invested, the number of passengers and tons of freight carried, the revenues accruing from the service, the expenditures involved in rendering it, and the earnings distributed annually as a result of railway enterprise.

There are about 250,000 miles of line in the United States, representing only single-track mileage.[1] If we include the length of second, third, and fourth tracks, and the mileage of yard tracks and sidings, the total mileage operated in the United States in 1914 was 377,102.

[1] The figures that follow are taken from *Statistics of Railways in the United States* for the year ending June 30, 1914. The single-track mileage as of that date was 247,397.

The significance of this vast mileage is strikingly emphasized by Professor W. Z. Ripley as follows:

> The total mileage of the United States is nearly equal to a ten-track railroad completely encircling the globe. The United States had already in 1900 about forty per cent of the aggregate mileage of all the countries of Europe combined. * * * Proportionately to population the United States is about six times as well equipped with railroads as Europe. Similar results appear with reference to superficial area. As compared with Europe alone, we have about two-thirds as much mileage to every square mile of territory, despite the fact that our density of population is only about one-seventh of that of Austria-Hungary —the most sparsely populated country in Europe.[2]

The figures for equipment are equally stupendous. There were, in 1914, 64,760 locomotives and 2,503,822 cars devoted to the service rendered by American railways. The number of employees was 1,695,483—the largest number of wage-earners engaged in any single American industry with the exception of agriculture. The outstanding securities amounted to $20,247,301,257, representing an apparent investment in railway transportation which is likewise second only to agriculture.[3] The number of passengers carried during the year 1910 earning revenue for the railroads was 971,683,199; the number of tons of freight hauled during the same year earning revenue for the railroads was 1,849,900,101. If we take distance into consideration and determine the number of passengers as well as the number of tons of freight carried one mile, the figures become so large as to pass beyond human con-

[2] W. Z. Ripley, *Railroads: Rates and Regulation*, 34-35.

For a statistical comparison of railway conditions in the United States and in European countries, see *Bulletin No. 24 (1911) of the Bureau of Railway Economics* (Washington, D. C.) on Comparative Railway Statistics of the United States, the United Kingdom, France, and Germany.

[3] These figures are based on the Interstate Commerce Commission statistics for carriers having an operating revenue above $100,000 per year for the year ending June 30, 1914.

ception. The number of passengers carried one mile in 1912 was 33,132,354,783, and the number of tons of freight carried one mile was 264,080,745,058.[4] The revenues from operation amounted to $2,842,695,382; the operating expenditures were $1,972,415,776; and the net operating revenue for the same year was $870,279,606. The immensity of these figures must be apparent to every one, and no further comment is necessary to indicate the vast extent of American railway interests.

The Significance of Railway Transportation

Its General Influence

But the significance of railway transportation cannot be measured by the mere extent of mileage or equipment, or by the mere magnitude of business operations. The railroad has without doubt introduced the most important of modern industries, and the development of railway transportation has revolutionized the very foundations of life. It has completely transformed our industrial, commercial, and social relations; and it has provided the strongest external force for the permanent unification of our national life.

When the application of steam to transportation was practically established and American energy set itself to the task of railway development, the old methods and the old conditions in almost every walk of life gradually dis-

[4] A ton of freight carried a distance of one mile is given the traffic denomination of one "ton-mile." If a freight train carries fifty tons of freight on its trip from A to B, a distance of 100 miles, it performs a traffic service of 50 times 100 or 5,000 ton-miles. In the same way a passenger carried one mile represents a traffic unit of one "passenger-mile."—Julius H. Parmelee, *Statistics of Freight Traffic.*

appeared. Mr. B. H. Meyer has aptly described these changes in the following words:

> The pack-horse, the stage-coach, and the country tavern, and all that goes with these, were soon superseded by other agencies better adapted to meet the new conditions of life. Limitless areas were transformed into fruitful farms, and the railways themselves became objects of wealth in the land whose value they had helped to create. The isolated settler was placed in touch with the world; and his wants, no longer dependent upon garden, or farm, or local market, could draw for their satisfaction upon the storehouses of the earth. The merchant's bazaar henceforth could offer commodities produced under many flags, and the man of learning exchanged ideas with scholars the world over. International unions—scientific, literary, industrial, and political even —sprang up in quick response to the throbbing of the larger life. The "bonds of consanguinity" concerning which earlier American statesmen expressed so much solicitude, could now be preserved indissolubly among all sections of our country. The government became omnipresent and the law omnipotent. Such was the revolution caused by the railway.[5]

ITS ECONOMIC FUNCTIONS

It is a commonplace of economics that production consists in the creation of utilities, in the endowment of matter with the quality or capacity of satisfying human wants. Primarily, matter is made more useful for purposes of consumption by a change in its form; as when a quantity of lumber, for example, is turned into a houseful of furniture. But commodities, even in their final consumable form, may be rendered more useful by being made available at the place where they are wanted. The railway, in transporting a carload of furniture from Grand Rapids to New York, is creating utilities no less truly than the manufacturer who transformed the raw material into the finished product; and those who are engaged in transportation are participating vitally in the

[5] B. H. Meyer, *Railway Legislation in the United States*, 4, 5.

productive process of the community. This creation of *place* utility by the transportation industries extends to the thousands of commodities each day offered for carriage on our American railways.

In a more fundamental sense, the economic function of railway transportation consists in furthering the geographical or territorial division of labor. Industries become established in the localities which afford the most advantageous conditions, and low rates of transportation enable the consumers in all parts of the country to enjoy the benefits of cheapened production. In widening the market for the products of industry, the railway creates the conditions essential to large-scale production and the development of a minute division of labor. In this manner it brings to the productive process the well-known economies of specialized machinery and labor-saving devices. The fundamental advantages of our modern factory system are dependent upon an extensive market, and the extent of the market is very largely determined by progress in transportation. For a more detailed consideration of the relation between the development of transportation and the effective employment of the division of labor, compare the following: [6]

> Progress in indirect cooperation, or the division of labor, depends upon the development of markets and other facilities for exchange For example, a man cannot be a shoemaker unless shoes are in demand by people willing and able to pay for them. Much less can a shoe factory be organized, with its elaborate subdivision of tasks and large output, unless shoes can be sold at remunerative prices. From this it may be inferred that every improvement tending to widen the market for goods is favorable to a further extension of the division of labor. The

[6] H. R. Seager, *Introduction to Economics* (3d ed.), 137-138.

truth of this conclusion is abundantly illustrated by the history of the last one hundred years.

Before the era of steam railways and steam vessels, the market for most products was necessarily restricted to limited areas near the source of supplies because of the high cost of transportation. Each region had to produce for itself its bulkier food articles, building materials, and implements, and could import from or export to other regions only those products which were light and costly. Under these circumstances the division of labor could be little practiced. Country districts afforded employment to a blacksmith, a carpenter, and a few other specialists. A few cities grew up where those goods which could pay the relatively high costs of transportation were manufactured. But the majority of the people were forced by the conditions to give their attention to agriculture as the only means by which they could earn a living. Steam and, more recently, electrical transportation have changed this situation. At present the cost of carriage offers no serious obstacle to the shipment of even cheap and bulky articles, such as wheat and coal, halfway round the world. For most goods, in place of a merely local market, there are now general markets ranging in magnitude from that afforded by a large city to that of the whole world. Perishable goods, services, and goods for which there is only a local demand, must still be produced on a small scale to satisfy local requirements, but the proportion of these goods to the whole mass of products is constantly diminishing. Even fruit and fresh meat have ceased to be perishable in the sense that they will not bear transportation to distant markets. Accompanying this widening of markets, there has been a concentration of special industries in special localities and of business management in fewer and fewer hands. In this way full advantage has been taken of opportunities for extending the division of labor, with the result that the volume of goods produced has enormously increased.

These conditions clearly show the absolute dependence of modern production upon an adequate transportation system.

ITS SOCIAL AND POLITICAL IMPORTANCE

In its social and political aspects the railway has strengthened the unity of the American people. It is indisputable that our highly developed system of railway transportation has contributed very largely to unifying into a single community of remarkable cohesion the one hundred millions of people scattered over the vast area of the United States. A healthy local pride clearly exists today, as it always must exist if each unit of the national realm is to contribute most effectively to the common life; but sectionalism of the sort which overemphasizes the local unit cannot withstand the cementing vigor of a highly developed transportation system. Closely akin to this gain in social unity has been the growth in political influence and efficiency. The American frontier was pushed farther and farther to the westward, and the desert plains and highlands were transformed into busy centers of social and commercial activity. Through progress in transportation representative government on a large scale was made practicable.

It is to be remembered, however, that the railway has been an important factor in bringing to the forefront the social problems that have accompanied our industrial growth. The industrial changes of the last century have come in no small measure through the instrumentality of the railway (although it was itself a natural outcome of the industrial revolution), so that the railway has helped to intensify the social problems which these changes have brought. These problems are bound up with the transition from the domestic to the factory system of production. They involve the substitution of the factory hand for the independent workman, the growth of classes with their threatening conflicts, and the exploitation of women

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and children in industry. The remarkable development of large cities, with their corrupting and stifling surroundings, at the expense of the more wholesome country life, has been one of the most pronounced results of this wonderful expansion. But these social problems, which are made acute by progress in transportation, are of the very nature of our modern industrial system. On the whole our social unity and political welfare have been immeasurably strengthened and enriched by the development of railway transportation.

Railway Regulation

In view of the vital importance of railway transportation to the welfare and development of this country, it is very evident that the service should be so conducted as to serve the best interests of all branches of commerce and industry and of the people as a whole. It will be seen, however, in a later chapter, that almost from the beginning of transportation, it has been found necessary to regulate the operation of transportation agencies, because these agencies, if left to themselves, do not develop their activities in such a way as to promote the public welfare. It is to analyze the chief problems in railway economics and to trace the development of railway regulation in this country that this text has been prepared.

In studying the succeeding chapters, the reader should bear in mind that the present conduct of American railways had its origin in the earliest conditions. Some acquaintance, therefore, with the historical development of railway transportation and with the gradual growth of the problems and principles of railway regulation is of very great value to the student of transportation who realizes that he must often know the origin of practices

and conditions in order to appreciate fully their present character and importance.

TEST QUESTIONS

1. Give briefly figures indicating the extent of the railway business in the United States at the present time.
2. Show the economic functions of transportation.
3. How have the railroads aided in the development of American business?
4. In what way does the American railway system increase the unity of the American people?
5. Why has it been found necessary to regulate the operation of transportation agencies?

CHAPTER II

THE PROBLEM OF REGULATION

Historic Foundations for Governmental Control

American railways are privately owned and privately operated. The problem of government regulation is the problem of harmonizing with the interests of the general public the private interests of those who appear as the legal owners and managers of the railways. That the public interest is vitally involved in enforcing reasonable rates, adequate service, and equality of treatment in the administration of railway enterprise appears from the magnitude and importance of the railway industry—from the extent of the physical properties of American railways, and from the economic significance as well as the social and political importance of the service which they render.

But the nature of American railway development presents further grounds for an intimate public concern in the methods and policies of private management of railway enterprise. The growth of our railway net has been exceedingly rapid. The American transportation system, comprising 250,000 miles of line, is the result of less than a century of development. The early railway ventures were necessarily speculative in their nature, and even when the efficiency of the railway as an instrument of modern commerce and industry had been established, rail-

way construction still proceeded in advance of actual needs.

As a result, the American people secured their railways early and in great abundance, but they paid the price of much speculative promotion and fraudulent financiering. The foundation for not a few of this country's large fortunes was laid in the manipulations which marked the early history of American railways. Some of the practices of the early days of railway promotion and railway construction have become notorious. We shall have occasion to examine them in the next chapter. But while the public tolerated these practices in the past, and may even be said to have encouraged them by "its insensate desire for swift development," there is no reason why the public should continue to tolerate such practices or continue indefinitely to bear the burden of past misdeeds.

From the historic standpoint, then, government regulation of railways is a positive assertion by the people at large that the old order has changed, that the methods which may have been inevitable in the early days of railway building [1] are no longer in harmony with an awak-

[1] Compare the following from F. W. Taussig, *Principles of Economics*, Vol. 2, pp. 393-94: "Historically, the course of development seems to have been controlled by a fated destiny. Given the impossibility of public ownership and management (and for the earlier stages of railway development in this country public operation was out of the question); given the eager desire of the community for ways of transportation and its willingness to encourage their construction in every way; given the looseness of corporation laws, the universal speculative temper, the laxness of business standards; given the periodic fluctuations in industry, the economic peculiarities of railways, the opportunities for large-scale ventures—and the harvest was prepared for the daring and able operator. Perhaps all the advantages from rapid construction, wide permeation of the land with railway facilities, from competition and consolidation and vigorous management, could have been got in some other way; but a train of deep-seated causes seems to have decreed that they should come in just this way and with just these checkered results."

ened public conscience, and that the present generation will not continue to pay tribute on the inflated railway values of the past, nor permit an unreasonable return for the performance of public service.

Moreover, though American railways are privately owned and privately operated, the public has lent no inconsiderable amount of direct aid to railway construction. Its desire for swift development showed itself in the form of gifts of public lands and loans of public funds. The nation, the states, the local governments, and private individuals all contributed to the development of our privately owned and privately operated railway net. The public interest, then, which aims to assert itself by a system of government regulation, is direct as well as vital.

The Legal Basis of Regulation

THE PUBLIC NATURE OF TRANSPORTATION AGENCIES

The historical characteristics of American railway development do not of themselves afford a sufficient basis for government regulation of the railway service. Neither the past misdeeds of the railways nor the generous aid of the public provide an adequate explanation of governmental activity. The right of the public to exercise control arises from the public nature of the transportation industry.

It is as much a function of the state to provide railways as it is to provide public highways, and corporations engaged in the transportation service are discharging a function of the state. The transportation agencies are engaged in a service which may properly be performed by the state itself, or may be delegated to private individuals or corporations under such supervision and con-

trol as the public may deem necessary.[2] The courts have repeatedly recognized this public nature of the transportation industries, and they have made it clear that the mere fact of private ownership and operation does not remove the railway from the class of public business.

A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the state. Such a corporation was created for public purposes. It performs a function of the state. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public.[3]

When private property is "affected with a public interest," it ceases to be *juris privati*[4] only. * * * Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but so long as he maintains the use, he must submit to the control.[5]

THE EXERCISE OF THE RIGHT OF EMINENT DOMAIN

The public nature of railways is clearly illustrated by the grants of power invariably conferred upon them to exercise the sovereign right of eminent domain. The

[2] Compare the proposition of State Senator W. H. Hatton of Wisconsin, as quoted in Charles McCarthy, *The Wisconsin Idea*, 39: "That it was as much the duty of the state to furnish transportation facilities as it ever had been to make roads or build bridges, and that if the function was delegated to any one, it was the duty of the state to regulate it, so that the agent should be required to furnish adequate service, reasonable rates, and practice no discrimination."

[3] Mr. Justice Harlan in Smyth v. Ames, 169 U. S. 466.

[4] That is, it ceases to involve mere private rights

[5] Mr. Chief Justice Waite in Munn v. Illinois, 94 U. S. 113.

right of eminent domain may be exercised, whether by the state or by private individuals or associations, only for public purposes.[6] The right of railway corporations, therefore, to compel the sale of private lands at reasonable prices involves, in its very nature, the use of those lands for public purposes.

Moreover, this right of eminent domain is practically indispensable to railway construction. Without the exercise of the state's right of condemning land, the railway company would be at the mercy of the owner of private land. Railways must be constructed along continuous lines. A given parcel of land, therefore, may become absolutely essential to the progress of a railway enterprise. By a refusal to sell, the landowner along the railway's proposed right of way would have the power to block the entire undertaking; or by holding out for an unreasonably high price, he would have the power to increase the cost of railway construction, and thus to impose an unnecessary burden upon railroad, shipper, and consumer. If railway companies were forced to secure their rights of way by purchase at private sale, without the sovereign authority of taking land at a reasonable valuation, they would find themselves held up by each successive property-owner and compelled to pay such sums as are determined, not by the value of the land, but by the owner's opportunity to take advantage of the necessities of these corporations.

The public nature of railway transportation appears the more clearly, then, from this fact, that the very exist-

[6] The rule of law is thus concisely stated in Wyman on *Public Service Corporations*, I, 48: "A legislature can give a railroad or a canal the right of eminent domain only because the company, irrespective of the enjoyment of that right, is already public in character; for private property, under our constitutional limitations, cannot be taken, even when compensation is given, except for public purposes."

ence of the plant upon which the performance of the railway service depends, involves the possession of the power to compel the owner of property to sell his land at a reasonable price. For practical purposes, therefore, the very possibility of railway transportation depends upon the exercise of the right of eminent domain, which is a public power possessed only by the state.

Only the state, therefore, can normally provide railways for the community; and when the state delegates this function, it must delegate with it the right of compelling the sale of private property at a reasonable valuation, which is essential to the normal prosecution of railway enterprise. The exercise of the right of eminent domain by railway companies is an example of sovereign power vested in private corporations because they are engaged in public undertakings; the need on the part of railway corporations of possessing this right of eminent domain suggests substantial grounds for considering these undertakings public in their nature.

THE RAILROAD AS A COMMON CARRIER

In many respects the law has imposed upon railroads the same special responsibilities which it had imposed upon the old common carriers before the days of steam transportation. All persons and corporations engaged in railway transportation on a public basis, the courts hold, are engaged in public employment and are to be considered common carriers.[7]

[7] For a statement of the historical process whereby the railroads assumed the position of common carriers and came to be so recognized by the courts, compare the following from Wyman on *Public Service Corporations*, I, sec. 176: "It is a matter of history that where the first railways were laid down at the beginning of the nineteenth century, the theory upon which they were constructed was that they would be public highways, for the use of which those that drove their vehicles over them should pay toll as for

From time immemorial English law has distinguished between persons who carry occasionally, under special contract, and those who profess to devote themselves to transportation as a regular business. In the case of the former, the carrying in which they are engaged is considered private business; in the case of the latter it is looked upon as public employment. By holding themselves out to serve the public generally in the transportation of persons and goods, such individuals or corporations deliberately and voluntarily take upon themselves special obligations to the public. In becoming common carriers they assume extraordinary responsibilities in many respects. They must serve all who apply; they must provide adequate facilities; they must charge reasonable rates; they must refrain from discrimination in rates and service; and they become subject to such other special measures of regulation as the state may lawfully impose.

In the early days the law of public service was applied only to the carriers then known—to hackmen, draymen,

the use of a turnpike or a canal. The introduction of the steam locomotive brought about the end of that theory almost before it was put into practice. A train drawn by a locomotive was too expensive, the operation was too costly, and its management too intricate for any shipper, or even for any private carrier. Almost from the outset, therefore, the railway company provided and operated the engines and cars themselves, and accepted for transportation such goods as were offered. They thus became common carriers. . . .

"In one of the earlier cases, Chicago & Aurora Railroad v. Thompson (19 Ill 578), the appellant railroad denied that it was a common carrier, because the charter of the corporation did not declare it to be so, but Mr. Justice Breese said: 'We suppose it is not necessary that the charters should provide in so many words that the railroad companies created by them shall be common carriers. The authorities are numerous to the point that such companies using cars for the purpose of carrying goods for all persons indifferently, for hire, and whose custom and uniform practice is to do so, are common carriers and liable as such. There can be no doubt on this point. There needs no legislative declaration to make them such.' "

stage-coach owners, ferrymen, and the like; in the eighteenth century came the regulation of toll bridges, turnpikes, and canals, as public callings; and in more recent times the courts have not hesitated to recognize that the owners of modern transportation agencies—railway, express, and steamship companies—are likewise common carriers, engaged in business that is essentially public in its nature.

The Economic Basis of Regulation

LEGAL VERSUS ECONOMIC CONSIDERATIONS

The foregoing considerations, legal in their nature, indicate the sources of governmental authority over railways; they show why the public has a right to subject railway companies to special control. There is very little controversy as to the right of the state to regulate. But the right to regulate does not necessarily involve the need of regulation. The need of a system of governmental control arises from the business nature of railways rather than from their legal characteristics. Most of the important questions involved in the so-called railroad problem can be traced to the economic character of the railway business, and throughout our discussion we shall be considering these characteristics from various points of view. It is sufficient, in this place, merely to indicate the general nature of these economic peculiarities and their most striking consequences.

THE MONOPOLISTIC CHARACTER OF THE RAILWAY BUSINESS

The need of regulation depends chiefly upon the monopolistic character of the railway business. In ordinary industrial enterprises the existence of competition, when free and unrestricted by artificial means, provides an

automatic force for the protection of the public. High prices and large profits in a given industry tend to attract additional capital to that industry, which results, in the long run, in a readjustment of charges and a reduction of net returns. In like manner, inefficient service and goods of inferior quality cannot permanently be imposed upon the public, because a policy which is clearly injurious to the interests of the consumer cannot permanently withstand the force of competition. The railway business, on the other hand, tends to be operated under monopolistic conditions.

To some extent railways are entirely exempt from competition. The amount of capital necessary for the construction of a railway is so large and the task of railway building is so substantial that competition is always relatively slow in becoming active. Capitalists will not unite so promptly in building a parallel road because of the large sums that must be risked in the enterprise; and even when they decide to enter upon such an undertaking, the work of construction requires so much time that active competition is still further delayed.

Moreover, even when the parallel road is built, it actually competes with the original line only at certain points—usually the more important cities—while at intermediate points the lines separate and pass through numerous small communities which have no other railway facilities. At these non-competing points, then, the railways usually enjoy a monopoly of local traffic; and while the number of non-competing points is gradually being reduced by the construction of new steam roads and the multiplication of electric railway lines, doubtless, because of the very nature of the railway, there will always be many localities which, in the absence of government control, will be at the mercy of one transportation

agency. In part, therefore, the railway business is clearly monopolistic in character.

In this respect the railway business stands in striking contrast to the more effective competition in water transportation. The highway between all ports is free to every one, except in the case of canals, and even these waterways are open to all on equal terms. The cost of vessels is small as compared with that of a railway and its facilities, and they may be constructed in a relatively short period of time. Moreover, vessels may usually be promptly purchased or chartered. The result is a strong tendency for competition on water to spring quickly into existence and to be very active; but even in water transportation competition is not as effective as it is under normal conditions in the manufacturing industries.

THE NATURE OF RAILWAY COMPETITION

The railway business, because of the character of railway competition, tends to be carried on under monopolistic conditions even when competition does exist. Railway rivalry tends to be abnormally keen and competition ruinous. This, in turn, leads to co-operation in various forms, and the inevitable result follows that railway competition becomes self-destructive. Competing railway companies, weary of the keen struggle which invariably ensues when competition becomes active, either consent to a truce whereby competition between them is abolished and arrive at an agreement for the maintenance of rates, or continue their warfare until one of the roads is driven to insolvency, and the unsuccessful line, upon reorganization, is taken over by its victorious rival. In either case effective competition is destroyed and monop-

olistic conditions are established.[8] The basis of this ruinous competition is to be found in the two following fundamental economic characteristics of the railway business.

JOINT COST AND RAILWAY MANAGEMENT

The services of a railway are rendered to a very large degree at joint cost. From one-half to three-quarters of a railway's expenditures must be incurred, regardless of the performance of any particular service. In order to conduct transportation at all, a roadbed must be provided, tracks must be laid, and terminals must be built. This plant is necessary for the transportation of passengers and freight as well as express and mail matter. Moreover, it is equally necessary for the transportation of different classes of passengers and different kinds of freight.

The expenditures for the fundamental purpose of providing the plant of a railway enterprise create the fixed charges of the business; and these fixed charges, the

[8] It is to be noted that in water transportation, in spite of very keen competitive conditions, the tendency to monopolistic control is not nearly as striking as in the case of railway transportation. Compare the following from E. S. Meade, "Capitalization of the International Mercantile Marine Company," *Political Science Quarterly*, XIX (1904), 50-65: "The [shipping] industry is strictly competitive. The high seas can never be monopolized. Dockage facilities in the leading countries are open to the ships of all the world, and shipyards will furnish a cargo steamer at a moderate price. Under these conditions, a permanent control of the shipping industry, sufficient to maintain rates or to control traffic, is out of the question. Agreements among the regular lines may introduce a certain degree of stability into passenger rates, and into the freight charges on the higher classes of commodities; but for the great mass of traffic, the raw materials and rough and half-finished products of commerce, carriers and shippers will continue, as they have from time immemorial, to make their individual bargains, and the rates of charge will continue to be fixed by the higgling of the market."

interest on the capital invested in the construction of the railway, form a part of the cost of every service rendered by that railway. As far as expenditures for plant are concerned, all railway operations are conducted at joint cost, and even the operating expenses are largely joint. The roadbed and equipment must be maintained in a state of reasonable repair and efficiency, many of the employees and much of the material necessary for conducting transportation must be provided, and most of the general administrative expenses must be met, regardless of the amount or the kind of traffic carried by the railway. In other words, a substantial proportion of the operating expenses, like the fixed charges, are constant.

It is practically impossible, therefore, for the railway manager to ascertain the exact cost of a given service. Rate-making must necessarily involve a large degree of guesswork, though it is true that this guesswork is entrusted to experts. Railway officials have no means of determining with certainty that rates have been reduced to unprofitable limits. Under the stress of keen competition, then, conditions are decidedly favorable to ruinous rate-cutting, and cut-throat competition inevitably becomes self-destructive.

INCREASING RETURNS AND RAILWAY POLICY

Railway operations are so largely conducted at joint cost because a very large proportion of railway expenditures is fixed or constant. If a railway is built and equipped and is carrying a given amount of traffic, it can usually handle a vastly increased quantity of business at a relatively slight additional expense. Within very wide limits, a given plant and equipment will accommodate a large as well as a small amount of traffic, and the only

additional cost involved in handling an increase in traffic will consist in that portion of the operating expenses which varies with the amount and kind of service rendered. In other words, the expenditures of a railway company do not keep pace with the services which it performs; an increase in traffic does not involve a proportionate increase in railway expenditures.

It follows, then, that with each increase in the amount of traffic carried, the cost per unit decreases; and the net revenues of a railway increase faster than the growth of its traffic. The railway business is thus subject to the law of increasing returns: every increase in traffic results in more than a proportionate increase in profits. Railway traffic managers, therefore, work under a powerful incentive to increase the volume of their business, and the competition for traffic is intense. In fact, the passion for traffic becomes the controlling passion of the railway business. Traffic managers consider it their most urgent duty to get business—to get it at the highest rates possible, but in any event to get it.

The profitable limit of rate reduction is so uncertain, because railway expenditures are so largely joint, and the advantage of extensive traffic is so great, because railway expenditures are so largely constant, that there is a natural and compelling tendency on the part of railway officials to reduce rates to whatever point may be necessary in order to attract business from competing lines. Ruinous rate wars follow, and competition tends to destroy itself. These conditions lie at the basis of the abnormal character of railway competition, which almost invariably leads to railway operation under monopolistic conditions. Competitive industries subject to the law of increasing returns naturally tend to monopoly.

RAILWAY COMPETITION AND DISCRIMINATORY PRACTICES

The keen rivalry for business leads not merely to rate wars and general rate-cutting, but to discriminatory practices as well. The passion for business is so intense that the traffic manager will resort to any means in order to get it. If the amount of railway traffic can be extended and hence the size of railway profits disproportionately increased by means of granting special privileges in the transportation of one commodity as compared with another, or in the case of one person or locality as compared with competing shippers or markets, railway officials will not hesitate long to resort to these discriminatory practices.

The history of American railways, and of our monopolistic industrial combinations or so-called trusts, divulges no greater evil than the granting of railway discriminations in rates and service for the benefit of one person, locality, or kind of traffic, to the prejudice and disadvantage of rival shippers, places, and industries. The motive or stimulus for these practices lies in the keen desire for additional business, with its resulting disproportionate increase in railway profits. Discrimination has been one of the most baleful as well as one of the most certain effects of railway competition.

RAILWAY DISCRIMINATION AND THE PUBLIC WELFARE

The danger as well as the injustice of discriminatory practices cannot be overemphasized. If our industrial life is to reach its natural and most efficient economic development, there must be freedom of enterprise and fairness of treatment for all persons, all sections, and all undertakings. In a sense, transportation is a fundamental industry underlying all others, for it is essential to the

conduct of all business and goes far towards determining the direction and conditions of industrial activity. The item of transportation, whatever it may be, is one of the elements in all costs, and the outcome of competition between different producers may be largely affected by any divergence in railway rates which must be paid by each of two or more competitors. It follows clearly, then, that the railway officials who make transportation rates exercise a tremendous power.

By the soundness of their adjustment of rates and by the degree of fairness with which established rates are observed, the railways may profoundly affect—or even absolutely determine—the prosperity of individuals, of industries, of cities and towns, or of entire sections of the country.

By discriminating between competing shippers, they may destroy the business of one and build up that of another, making one man rich and another poor.

By stimulating or discouraging a particular class of traffic, they may increase or diminish the importance of industries and the extent of production in particular lines of commerce, thus shaping the direction of industrial activity.

By discriminating among cities and towns, they may cause one to grow and another to decay, and thus determine the commercial importance of business centers.

By modifying their rate schedules in special instances, they may determine the location of industries, guide the movements of population, and affect the prosperity and welfare of extensive localities.

By these unfair practices the railways also have it within their power to build up industrial monopoly; and the most powerful of the trusts against which the people are now struggling made their first advances towards

control of the market through the agency of special favors in the form of railway discriminations.

The Problem of Regulation

THE NEED OF GOVERNMENT REGULATION

The need of government regulation follows clearly, then, from the economic character of railway transportation. Competition cannot be relied upon as a regulating force. When it is resorted to by competing railways, it introduces evils of its own that are vitally prejudicial to the public welfare. It causes instability of rate adjustments, industrial fluctuation, and gross discrimination between rival shippers, different classes of traffic, and competing business centers. The abnormal nature of this competition makes it of temporary duration. Cooperation of some sort, whether by actual consolidation or by mere agreement, almost invariably follows.

The problem resolves itself, therefore, into a consideration of what constitutes a wise attitude towards private monopoly; and from time immemorial it has been a cardinal principle of English thought that private monopoly cannot wisely be left unregulated. Government regulation is necessary in order to correct the evils which are inseparable from railway competition, whenever bona fide rivalry exists, and to prevent the abuse of monopoly power, whenever, as is the normal tendency in the railway business, operations are conducted under monopolistic conditions. It is inconsistent with any sound present-day economic policy that a power over the public as great as that enjoyed by the railways should be exercised by private persons without direct responsibility to the people.

THE DANGERS OF EXCESSIVE REGULATION

The railway industry in the United States possesses a private as well as a public side, and a genuine consideration of public welfare demands the proper protection of the private interests involved. American railways are privately owned and privately operated. Our whole economic structure is based upon a faith in the efficiency and far-reaching advantages of private enterprise. Under this system the American railway net was built and developed, attaining a physical extent and an operating effectiveness unparalleled by any railway system in the world. This railway net must be maintained and extended, accommodating existing needs and adjusting itself to the economic changes in the community. To perform this task effectively, further investment in railway enterprise is necessary, and in order that this additional capital may be forthcoming, the investing public must not be lost sight of in the application of a system of public regulation. Moreover, what is more important, if our faith in private enterprise is to continue, the powers and activities of the regulating authorities must not be so extensive as to destroy the exercise of private initiative.

The railways must be made to recognize the public nature of their undertaking, but within the limits of public welfare they must be restricted as little as possible in developing the American transportation system. The dangers of regulation, then, consist in the establishment of excessive regulation in the name of public policy. A very important element of public policy involves the demand that railway operations be conducted under conditions of highest efficiency, and it is still a basic principle of American industrial institutions that the

highest economic efficiency can be attained through the medium of private enterprise. The state must not undertake to operate the privately owned railways, and its policies of regulation must not be so extensive as to discourage that enterprise and initiative which have been so remarkably effective in American railway history.

THE ESSENCE OF THE TASK

There is almost as little controversy today on the need of regulation as there is on the right of the state to regulate railway transportation. The representatives of the railways as well as the advocates of the people admit the need of regulation. Both the principle and the practice of regulation are now well established. For almost half a century the states have been exercising administrative control over railways, and it is more than twenty-five years since Congress passed the Act to Regulate Commerce and created the Interstate Commerce Commission. The conflict today concerns itself with the extent or degree of governmental control.

The problem of regulation is to harmonize public and private interests, to develop a system whereby the public welfare will be promoted and private enterprise will be stimulated. That is the essence of the task, and it presents an ideal difficult of attainment. The chapters that follow will consider in detail the specific problems which that task presents and the policies and methods followed by the states and the national government in performing the important duties of railway regulation.

TEST QUESTIONS

1. On what historic basis does the governmental control of carriers rest?
2. Why are the railways allowed to exercise the right of eminent domain?
3. What is the meaning of the term "common carriers"?
4. Why is the railway business naturally monopolistic?
5. Why is joint cost such an important factor in the management of railways?
6. What is meant by the term "increasing returns" in connection with transportation?
7. Why does railway competition naturally lead to discrimination?
8. Why is railway discrimination so injurious to business interests and to the public welfare?
9. Why is there such a strong need of government regulation of transportation agencies?
10. What are some of the dangers of excessive regulation?

CHAPTER III

AMERICAN RAILWAY DEVELOPMENT

The Development of Railway Transportation

THE ANTECEDENTS OF THE RAILWAY

In view of the vast extent of our present railway net, it is difficult to realize the fact that railway transportation in the United States is not a century old. As late as 1830 turnpikes and canals, together with such rivers as were navigable, constituted the chief means of transportation. The development of turnpikes and canals became a serious enterprise soon after 1790, partly in fulfilment of the government policy of internal improvements, and partly through private enterprise, stimulated by substantial aid received from both the national and the state governments.

The most important highway or turnpike was constructed by the United States. It was known as the Cumberland Road, or "National Pike." It started from Cumberland, Maryland, which was then about the center of population, extended across the middle west through Ohio and Indiana, and finally reached Vandalia in Illinois. It was begun in 1806, and its final stretches were completed in 1827. The original intention was that this turnpike should extend to St. Louis or Jefferson City, Missouri, but the superiority of canals and the possibility

of railways became clearly established before this plan could be carried out.

The construction of canals constituted an advance upon the building of toll roads. There was much activity in canal building, particularly after the war of 1812, and much capital, often secured from the states as subsidies, was wasted. The most important and the most successful undertaking of this sort was the Erie Canal, connecting the Hudson River and Lake Erie at Buffalo. This was begun by the state of New York in 1817 and was completed in 1825. It was profitable from a financial standpoint and succeeded in giving the city of New York the leading commercial position which it now holds.

The completion of the Erie Canal in 1825 came, however, only a few years before the successful use of the steam locomotive. As soon as the practicability of the railway was proved, its superiority to all other means of transportation began to be universally recognized. By about 1840, therefore, activity in canal construction entered upon a noticeable decline, and by the middle of the century it had practically ceased.

THE BEGINNINGS OF THE RAILWAY

Railways in the strict sense of the term—that is, roads provided with rails upon which wheels could run—had existed in England for about a century and a half before railway transportation in the modern sense had been developed. The application of steam to transportation constituted the great change. The essence of this change consisted in the substitution of mechanical for muscular power in the transportation of persons and the carriage of goods. As early as 1807 Robert Fulton established conclusively the practicability of steam navigation (many experiments, with varying degrees of success, having

been undertaken during the preceding two decades), and thereafter steam vessels multiplied with great rapidity. But the success of the steam locomotive as we now know it was not assured until 1829, when George Stephenson, in a trial test on the Liverpool and Manchester Railroad, demonstrated that his famous locomotive, the "Rocket," could attain a speed of 29 miles an hour.

With the locomotive on a practical basis, railway transportation in the modern sense was permanently established. The construction of the Baltimore & Ohio road marks the real beginning of the railway in the United States. The significance of this early railroad building was strikingly emphasized by President Hadley of Yale when he wrote, in 1885:

> On the fourth of July, 1828, Charles Carroll, last surviving signer of the Declaration of Independence, laid the first rail of the Baltimore & Ohio Railroad. One man's life formed the connecting link between the political revolution of the last century and the industrial revolution of the present.[1]

During the early years of railway enterprise construction was undertaken on a small scale. The Charleston & Hamburg Railroad of South Carolina, for example, which was chartered in 1829 and had 137 miles of line in operation by 1834, was for a short time considered the longest line in the world under a single management. In 1835 the Pennsylvania Railroad, with a little more than 200 miles of line, had about a quarter of the entire railway mileage in the United States.

Moreover, in the beginning people were not altogether unanimous in their support of railway enterprise, even after the superiority of the railway over all other means of transportation had been clearly established. Opposi-

[1] A. T. Hadley, *Railroad Transportation*, 1.

tion was manifested in many quarters. Those who had invested in the construction of turnpikes and canals bitterly resented the intrusion of railway competition, and so powerful was the influence of canal interests that in some cases railways were at first denied the privilege of carrying freight. Farmers, tavern-keepers, and others who anticipated that railway progress would injure their personal interests also made vigorous protests. But the fundamental advantages of railway transportation made the acceptance of the new agency inevitable, and finally popular enthusiasm for railway construction effectively silenced the voice of all opposition.

THE GROWTH OF RAILWAY MILEAGE

A mere *résumé,* by decades, of the growth of railway mileage will indicate the remarkable rapidity with which the American railway net was developed. In 1830 there were but 23 miles of steam railway in the United States. Ten years later the mileage had increased to 2,818, and in another decade the total had reached 9,021 miles. During these two decades construction had been largely confined to the seaboard states, and especially to the northeast, most of the lines radiating from the Atlantic seaports. Then came the development of the south and the west, and the prosperity incident to the discovery of gold in California in 1848. The north central states became well covered with tracks in a surprisingly short time. By 1860 the railway mileage of the country was 30,635, and by 1870 it had increased to 52,914 miles. The panic of 1857 and the Civil War naturally exercised a depressing influence on railway construction, as they did on all enterprise.

In one way, however, the war served as a stimulus to railroad building. A transcontinental route had long

been the subject of discussion, but it became a reality only when the war made it politically important to unite the Pacific coast with the north and to provide adequate means of sending troops and military equipment to the west, if occasion should arise. Accordingly, in 1862, Congress passed an act under which the Union Pacific road and its connections were built from Omaha to California, and again, in 1864, an act providing for the construction of the Northern Pacific road. At the conclusion of the war further grants were made for western railway extension, other transcontinental roads being thereby gradually established.

By 1880 the railway mileage of the country had increased to 93,296. From 1868 to 1873 there had been feverish activity in railway building, the speculative nature of many of these undertakings largely contributing to the panic of 1873. For the five years that followed, from 1873 to 1878, there was a comparative lull in railway construction, and then began the most remarkable period of expansion in the history of transportation. In the decade from 1880 to 1890 more than 70,000 miles of line were constructed, making the total mileage 163,597. The following decade witnessed more conservative extension, partly because the depression following the panic of 1893 was unfavorable to railway construction, and partly because the rapid building of the previous ten years had supplied many parts of the country with adequate facilities. Nevertheless the mileage in 1900 had increased to 193,346, and on June 30, 1912, there were 249,852 miles of railway in the United States.

INTENSIVE DEVELOPMENT OF THE RAILWAY SERVICE

An adequate exposition of how the railroads in this country have increased not only in length but in capacity

for handling traffic, more powerful locomotives, larger cars, etc., is beyond the scope of this text. It would include a discussion of the technical growth of the mechanism of the railway—of the track, the locomotive, the passenger-coach, the freight-car, the terminal facilities; it would involve not merely such questions as the comparative tractive power of locomotives and the comparative capacity of freight-cars, but also a discussion of the recent developments in transportation by means of electrical power. This last has resulted in a rapidly growing net-work of interurban electric railways and in the appearance of the increasingly important problem of the electrification of steam railways. A mere enumeration of the various classes of cars now used on American railways—passenger, dining, parlor, sleeping, baggage, express, postal, box, flat, stock, coal, tank, refrigerator—indicates the extreme differentiation of the service for the greater convenience of the users of railway transportation.

But at this point, in connection with the preceding discussion of the growth of railway mileage, it is particularly important to note that, in addition to extending their lines, the railways have enlarged their capacity for serving the public by constructing additional tracks. The double tracking of the New York Central Railroad, the first in this country, was not accomplished till the Civil War. In recent years the growth of additional trackage has been very rapid. From 1890 to 1907, for example, while railway mileage (single-track) increased only 40 per cent, the amount of second track increased 130 per cent (from 8,438 to 19,421 miles), the amount of third track increased 157 per cent (from 761 to 1,960 miles), and the amount of fourth track increased 147 per cent (from 562 to 1,390 miles). The mileage of yard tracks

and sidings also increased 130 per cent (from 33,711 to 77,749 miles) during that period, and in 1912 the total trackage actually in operation amounted to 371,238 miles, as compared with 249,852 miles of line.

Public Aid to Railway Construction

The Nature and Purposes of Public Aid

In the development of American railways the attitude of the public toward railway corporations has undergone extreme variations—having changed from the establishment of a policy of liberal aid and encouragement to the withdrawal of all assistance and the adoption of a policy of restriction and regulation.

In the earliest days some of the states directly undertook the construction of railways as government enterprises. This policy was short-lived. The panic of 1837, and the long depression that followed, found many states in such a deplorable financial condition that they were practically compelled to abandon their work of railway construction and even to sell to private companies the roads they had already built. This they usually did at a sacrifice. The state of Michigan sold its southern road to the Michigan Southern Railroad Company for little more than half of its actual cost.

What happened in Michigan was typical of the whole western situation. In the early days of its statehood it had planned and partly built two lines of railroad across its lower peninsula, from east to west. So severely, however, was the state shaken by the panic that, in spite of its heroic efforts to meet its obligations, the word Michigan became a scarecrow to eastern capital. As the years went on and there proved to be no possibility of completing the roads or even of procuring the money necessary to keep them in repair, it grew plain that the state must get rid

of them. One, the Michigan Central, one hundred and forty-five miles long, ran from Detroit to Kalamazoo. The other, the Michigan Southern, also ran nowhere, but achieved the same result with less effort, being only seventy-five miles long.[2]

While the states early withdrew from direct operations in the field of railway enterprise, however, they did not so soon relinquish the policy which they had pursued almost from the beginning of railway transportation—that of giving substantial aid to private companies. In this policy the states were joined by local governments and individuals, and later by the federal government, with the result that until about 1870 railway building was largely stimulated by extensive public assistance. The contributions of the state and local governments, as well as of private individuals, were made primarily as a means of developing the industrial and commercial importance of particular localities by securing access to new markets. The federal government was actuated not only by a desire to push the frontier westward by promoting the settlement of the country, but also by the necessity of providing better transportation facilities for the handling of the mails and the movement of troops. The importance of railways for the movement of troops has been amply illustrated in the European war which started in 1914.

STATE AND LOCAL AID

The aid to railway construction rendered by the state and local governments took many forms. Actual donations in cash were made in large amounts by cities and other local units, and to a smaller extent by the states.

[2] H. G. Pearson, "An American Railroad Builder," 23, 24, as reprinted in Ripley, *Railway Problems* (revised edition), 62.

The loans of credit and of money that were made to railway companies likewise turned out to be mainly gifts, only a portion of them ever being repaid by the companies.

One of the most common forms of government aid was the purchase of railway stocks and bonds with public funds. The hope that the investment would prove profitable, the returns by the railway companies more than equaling the interest paid by the state for the money borrowed, was very seldom realized. States and cities also assisted the railways by guaranteeing their bonds, or by guaranteeing interest on bonds and dividends on stock.

Land grants were also common, both from cities, as sites for stations and yards, and from many of the states, for rights of way and for general railway purposes. Texas alone granted portions of its domain which equaled in area the whole of New York State.

NATIONAL AID

The promotion of railway enterprise was stimulated by the federal government through large grants of land and generous loans of public funds. The federal land grants began about 1850. Statute after statute was passed providing for grants of land from the national domain. The transcontinental roads were the most favored beneficiaries of these grants. It is estimated that the direct land grants of the national government, between 1862 and 1871, amounted to 26,000,000 acres, or some 40,000 square miles, and that the total land grants, between 1850 and 1871, amounted to 155,000,000 acres, or some 242,000 square miles.

These public land grants exceed in area the whole of the German Empire; they comprise an area four times as

great as that of all the New England states. In addition to these grants of land, the federal government loaned the transcontinental roads, particularly the Union Pacific and its connections, no less than $64,623,512 in United States bonds.

THE EXTENT OF PUBLIC AID

It is practically impossible to determine with certainty the full extent of the aid received by American railways from the federal, state, and local governments. Even the most painstaking investigations must rely merely upon estimates in many particulars. In some cases the aid described in the legislative enactments was never fully received, the railways failing to comply with the specified conditions. In other cases, it has been discovered, assistance was given in excess of that authorized. The public bonds given to railways were often sold at a discount, so that the actual sums received were not equal to the nominal amounts specified in the laws. The extent to which loans to railways became gifts because of nonpayment cannot be accurately determined. It is impossible to ascertain how much actual cash has been realized by railway companies from the enormous gifts of land conferred upon them by the nation, the states, and the local governments; and it is difficult even to estimate satisfactorily the value of rights of way, depot grounds, materials, and other property received from the public. But that the total amount of such public aid was enormous—running into hundreds of millions of dollars—is evident even from the most cursory examination of the facts.

The Speculative Character of American Railway Development

CAUSES OF SPECULATIVE CONSTRUCTION

The policy of public encouragement of railways, so lavishly pursued at first, was gradually relinquished, and early in the seventies it had been practically abandoned. In part this change of policy was due to the fact that many of the state and local governments were plunged so heavily into debt, and were laboring under such heavy burdens of taxation, that some of them were compelled to repudiate their obligations. To a large extent, however, the change of attitude on the part of the public may be ascribed to the speculative character of American railway development.

Most of the railroads of the United States were built to accommodate the needs of the future and not of the present. Moreover, though the earliest roads secured their capital by stock subscription, most of the lines were built with money borrowed through the issue of bonds. As a result of these conditions the spirit of speculation permeated most railway enterprise, and much of the speculative activity ran over into fraud and corruption.

Furthermore, the system of government aid accentuated these tendencies to fraud and corruption. The public subsidies not only resulted in the construction of roads long before the commercial necessity for them had arisen, but they led to extravagant expenditures, attracted financial adventurers, and encouraged irresponsibility in the use of both private and public funds. The bounty of the government was frequently accepted by promoters largely because public aid could be used as a basis for profitable speculation.

CONSTRUCTION COMPANIES AND FINANCIAL MANIPULATION

This speculative character of American railway building has led to financial manipulation and fraudulent practices. The Erie Railroad, for example, between 1868 and 1872, increased its capital stock from $17,000,000 to $78,000,000; and these issues were very largely, if not exclusively, made for the purpose of manipulating the market. Many of the roads paid excessive sums to construction companies under the control of men who were also in control of the railroad companies. These practices have been frankly admitted by railroad men as well as emphasized by impartial students of the railroad problem. The methods of the early railway promoters have been strikingly described by a former railway president:

> Their plan was to procure the most favorable charters from the states or the Government, to obtain large concessions in lands along the line, then organize a company, issue as many bonds per mile and as much stock as they thought the public would take, obtain from cities and towns as large subsidies as possible in money and promises, then make contracts with themselves by which they received all the lands, subsidies, bonds and stock for constructing the railway. They constructed it as cheaply as possible, they sold the lands for the best price obtainable, sold the bonds and stock to the public, and then marched on to take other contracts and conquer other lands. When the day of reckoning came, as it was bound to, the public found itself the owner of bonds upon which the interest could not be paid, and the communities found themselves with a poor railway in which they had no direct pecuniary interest. They saw the contractors with enormous fortunes, and they concluded that they had been cheated and robbed.[3]

Professor Ripley of Harvard University has described these methods, which "correspond pretty closely with the

[3] From a lecture by M. E. Ingalls, in the Purdue University *Lectures in Railroad Engineering and Allied Subjects*, 71, 72.

methods of the notorious Credit Mobilier and other companies concerned a generation ago in the construction of our transcontinental roads," by the following concrete hypothetical example:

A knot of promoters planning an enterprise first formed a railroad corporation and authorized, let us say, capital stock to the amount of $1,000,000. This consisted of 10,000 shares, par value $100. The stock was issued to themselves part-paid ($10 per share), $100,000 in all being temporarily borrowed by them individually for the purpose. A glowing prospectus then offered for sale two millions of bonds with the proceeds of which the road was to be built. These bonds were sold at 80, with perhaps a bonus of stock thrown in, thus realizing $1,600,000 in cash. From this the promoters reimbursed themselves for the $100,000 already advanced, by charging a 5 per cent commission for marketing the bonds. This enabled them to pay off their personal loans. It left $1,500,000 cash in the treasury of the railway corporation as well as a controlling portion of its own capital stock. The next step was the organization by these same directors of a construction company, which built the road for an actual outlay of $1,200,000. The railway directors now voted to pay their construction company $1,500,000 in cash for this work and in addition the remainder of the share capital of the road. A profit to themselves of $300,000 plus the prospective value of the capital stock, which had cost them nothing, obviously resulted. If the enterprise were henceforth profitably operated, all well and good. If not, it might fail even to pay interest on its bonds. If bankruptcy ensued, a receiver, possibly representing the old stockholders rather than the bondholders, was appointed. In any event the promoters had realized 300 per cent on their first investment, itself borrowed, from the profits of the construction company. Moreover, they still controlled the railroad through its capital stock. Thus were the foundations of a number of large fortunes laid—enough, that is to say, to envelop American railroad construction in an atmosphere of disrepute by no means generally deserved.[4]

[4] W. Z. Ripley, *Railroads: Finance and Organization*, 18.

The Beginnings of Regulation

CHANGES IN PUBLIC POLICY

The change in public attitude towards the railways manifested itself in other ways than by the mere relinquishment of the policy of public aid. Late in the sixties the dissatisfaction and evils incident to the adjustment of railway rates began to attract general attention and to form the basis of popular discussion. In some measure these evils had already existed for a number of years, but it was not until after the close of the Civil War that they aroused widespread indignation.

In the early days the public had enthusiastically supported railway enterprise, for it saw only the progress and the enlarged opportunities which followed railroad building; but when the roads were built and ample facilities were provided, the people came gradually to learn that those in control of the railways occupied positions of extraordinary power, and that the manner in which this power was exercised was not always conducive to the general good. Complaints arose in greater and greater number against the burdens of excessive railway charges and against the dangers of monopoly control in private hands. A spirit of hostility began to be manifested against railroad companies; the railway owners, who had once been looked upon as public benefactors, began to be denounced in unsparing terms.

The truth is simply that the inevitable had happened. The railway was now old enough to indicate its immense power over the social, political, and industrial life of the nation, and the nature of the railway business was such that, if the railways were left entirely in private hands, the public interest must necessarily be jeopardized. As this truth forced itself upon the minds of the people, the

subject of public aid was forgotten, and there arose in its stead an insistent demand for government regulation of railways. So effective was this agitation that several states immediately established systems of public control; and so persistent have been the evils involved in the adjustment of rates and service that the precedent set in the early seventies by a few of the states has been followed by the nation and by nearly all of the state governments.

THE METHODS OF PUBLIC CONTROL

When the American people became aware of the existence of pressing evils in the administration of our railways, they might have adopted any one of several different methods as a means of meeting the situation. On the one hand, they might have placed their reliance upon the potency of competition for the establishment of desirable conditions in the railway business. To no small extent the popular agitation directed itself to the maintenance of railway competition. But while this plan once had numerous advocates, and still has not a few, they have rapidly diminished in number as the realization has been forced upon them that competition itself is responsible for much of the difficulty, because of the abnormal form which it assumes in connection with railway enterprise.

On the other hand, as another possible extreme, the people might have adopted public ownership as a solution of the evils springing from private management; but a change of so radical a character was not permitted or seriously considered by the spirit of conservatism which prevails in our political affairs.

Between these two extremes two middle courses were possible: one, to rely upon the common law for the redress

of injuries inflicted by railway misdeeds; and the other, to establish a system of government regulation.

The first of these did not promise adequate relief. In the matter of discrimination there was some question whether the common law imposed emphatic prohibition; the courts, moreover, do not possess the necessary machinery for enforcement. Against the practice of extortion the relief of the common law was likewise inadequate. It is true that the law imposed upon common carriers the duty of providing transportation at reasonable rates, but here again machinery of enforcement was lacking as before.

The only remedy open to a shipper who had been forced to pay an exorbitant rate was to sue for recovery of the excess payment. Such suits could not be relied upon to provide adequate protection for the public, for the amount to be recovered by the particular shipper would necessarily be small, and the expense and delays incident to litigation would frequently prevent shippers from availing themselves of this remedy. Moreover, even if damages were recovered, the railway would still be free to repeat the offense in the future. The only effective alternative open for the people, then, was the establishment of a system of public supervision and control.

THE APPEARANCE OF RAILWAY ABUSE

Such a system of government regulation was first established in the states of the middle west—in Illinois, Wisconsin, Minnesota, Iowa, and Missouri. These states were the leaders in railway regulation because it was in their borders that railway abuses first became so numerous and so oppressive as to provoke a strong anti-railway sentiment. In the late sixties and the early seventies the population in these states was comparatively sparse and

scattered. Railway traffic, therefore, was light, and hauls were long. As a result the railways were driven to increase their revenues by charging high rates wherever it was possible to do so. Moreover, new lines were being built with greater rapidity than the industrial condition of the country required, so that an intense rivalry for traffic was developed, resulting in local favoritism and the general disregard of distance as an element in rate-making. Complaints of extortion and discrimination thus became common and resentment against the railways was everywhere nourished.

There were other causes, too, which conspired with these rate abuses to create a hostile feeling. The railways were owned to a large extent by eastern or European capitalists who "were regarded by the farmer as the absentee land-owner is regarded by the Irish tenantry. Whatever was paid to the railroad-owner seemed like so much direct drain on the resources of the community." [5] There was also the widely prevalent idea that, because rival roads voluntarily fixed a given rate between competing points, they could necessarily afford to carry for that rate, and hence for much lower rates between intermediate points. The feeling spread, therefore, that most of the farmers were being made the victims of the greed of railroad-owners; and the decline in the prices of agricultural products made them feel the burden of transportation rates even more heavily.

THE GRANGER LEGISLATION

These conditions produced in the middle west a widespread agitation for government regulation of railroad rates. This cause was espoused by the farmers' granges, so that the entire agitation came to be known

[5] A. T. Hadley, *Railroad Transportation*, 133.

as the Granger Movement and the laws in which it culminated as the Granger Legislation. This legislation, which was enacted between 1871 and 1875, established a system of public control in which reliance was placed in part upon commissions and in part upon the force of statutory provisions.

The idea of railroad regulation through commissions was not a new one: for some thirty years a few commissions had existed in the eastern states. The powers of these commissions had been very limited in their scope. As a general rule their duties were confined to the inspection of the physical properties of railways for the purpose of preventing accidents, the collection of statistics, and the investigation of alleged violations of the law or of the charter provisions. At first they possessed no authority over rates, but with the development of abuses connected with rates, and especially with the growth of anti-railway agitation, it was seen to be necessary to clothe these commissions with some power of rate-control.

In the beginning the Granger states were disposed to rely upon direct legislative regulation rather than upon the activities of administrative commissions. Statutes were enacted which forbade extortion and unjust discrimination, making such practices penal offenses, and prescribed schedules of maximum rates to be observed by the railroads. The general prohibitory clauses have been permanently retained in the present railway legislation of all the states; the maximum rate provisions have been abandoned in many of the states and superseded by new enactments in others. On the whole, the tendency of the Granger Legislation was to make the work of commissions the chief feature of their systems, confining their direct rate legislation to general

provisions prohibiting unreasonable and discriminatory rates and practices.

THE ATTITUDE OF THE RAILWAYS

The attitude of the railways towards this complete reversal of governmental policy—from the practice of public aid to the enforcement of public control—was naturally one of resentment and opposition. Their protests were vigorous and bitter; they denounced the legislation on manifold grounds. They denied that the state possessed any rightful authority to regulate rates; they asserted that the states had violated the rights guaranteed to the railways by their corporate charters; they assailed the laws as unwarranted attempts to regulate interstate as well as local commerce; and they asserted that the rates fixed by law were so low that they would prove ruinous, depriving the railway-owners of any return on their investment, discouraging further capital from the field of railway enterprise, bringing railway construction to a standstill, and seriously crippling American industry.

In spite of this vigorous and varied attack, the railways received very little relief through judicial channels; the legality of the legislation was very generally upheld. Nor, in all probability, would the railway protest have produced much effect upon the public mind, if extraordinary circumstances had not arisen. But a severe panic occurred in 1873, followed by a long period of depression. During this period all forms of business enterprise, including railway construction, were seriously curtailed. The idea was suggested, and was diligently fostered by those interested, that the Granger Legislation had caused the cessation of railway extension. This was true in some small measure, in so far as capital was watching the

effects of the new laws; but for the most part the situation in the railway field was merely a phase of that affecting all business. Nevertheless these unusual conditions resulted in temporarily abating the vigor of government regulation. There was some reaction in public sentiment from the extreme to which it had gone; some leniency was shown in the enforcement of the laws; and a few states—Wisconsin, Iowa, and Minnesota—relaxed their rigorous systems of control and placed the supervision of railways in the hands of commissions with only advisory powers as to rates.

This relaxation, however, was only temporary. The movement for railway regulation has made irresistible headway, so that today it is nation-wide and thoroughgoing. It may be noted further that the carriers as a whole not only follow the letter of the various orders of the regulating bodies, state and interstate, but concede that regulation is beneficial to them. The chapters that follow are devoted to a more detailed consideration of the nature and extent of this regulation.

TEST QUESTIONS

1. Describe very briefly the development of American railway transportation.
2. In what ways has the public aided in the construction of railways in this country in the past?
3. Why did speculation naturally enter into the construction of some of our earlier railways?
4. How were construction companies utilized in financing some of our early roads?
5. Trace briefly the events which led up to the regulation of railways in this country.
6. What was the first attitude of the railways towards regulation?

CHAPTER IV

RAILWAY COMPETITION

The Nature of Railway Competition

RAILWAY COMPETITION AND ITS EFFECTS

We have seen in an earlier chapter that the railway business may be said to be naturally monopolistic. In local traffic[1] the railways often possess an absolute monopoly, the shipper being dependent for his service upon a single line of railway. But even in competitive traffic the railways tend to be operated under monopolistic conditions because of the peculiar nature of railway competition.

The abnormal, ruinous, self-destructive character of railway competition rests upon the economic characteristics of the railway business. From one-half to three-quarters of railway expenditures are both joint and constant, thus making it practically impossible to ascertain the exact cost of a specific service and creating an abnormal rivalry for railroad traffic. Destructive rate wars and ruinous as well as unjust discriminatory practices are the inevitable results. Because of the specialized character of railway property abandonment of the field is impossible; even insolvency, therefore, only brings a reorganization under which the weaker rival is absorbed

[1] The term "local traffic" as here used signifies traffic at a point served by only one railroad.

by the stronger one. In most cases there is an irresistible stimulus to resort to some form of co-operation before the almost certain outcome of active rivalry drives competing railways to merge their interests.

Effective competition, then, in the sense in which it appears in ordinary industrial enterprise (and in which it is said to be "the life of trade"), cannot be said to exist in railway transportation as an automatic safeguard of public welfare. Indeed, it tends to produce evils more grave and more injurious to the public interest than those which it is relied upon to eliminate.

COMPETITION IN TRADE AND IN TRANSPORTATION COMPARED

The true nature of railway competition emerges the more clearly when it is compared concretely with competition in trade. The following analysis by President Hadley, of Yale University, presents such a concrete application of the principles under discussion:

> There is a marked difference of principle between mercantile competition and the competition of railroads. In the former case its action is prompt and healthful, and does not go to extremes. If Grocer A sells goods below cost, Grocer B need not follow him, but simply stop selling for the time. For: (1) This involves no great present loss to B; when his receipts stop, most of his expenses stop also. (2) It does involve a present loss to A; if he is selling below cost, he loses more money the more business he does. (3) It cannot continue indefinitely. If A returns to paying prices, B can again compete. If A continues to do business at a loss, he will become bankrupt, and B will find the field clear again. But if railroad A reduces charges on competitive business, railroad B must follow. (1) It involves a great present loss to stop. If a railroad's business shrinks to almost nothing, a large part of its expenses run on just the same. Interest charges accumulate; office expenses cannot be

suddenly contracted; repairs do not stop when traffic shrinks, for they are rendered necessary by weather as well as by wear. (2) If B abandons the business, A's reduction of rates will prove no loss. The expense of a large business is proportionately less than that of a small one. A rate which was below cost on 100,000 tons may be a paying one on 200,000. (3) Profitable or not, A's competition may be kept up indefinitely. The property may go into bankruptcy, but the railroad stays where it is. It only becomes a more reckless and irresponsible competitor. The competition of different stores finds a natural limit: it brings rates down near to cost of service and then stops. The competition of railroads finds no such natural limit. Wherever there is a large permanent investment, and large fixed charges, competition brings rates down below cost of service. The competitive business gives no money to pay repairs or interest. Sometimes the money to pay for these things comes out of the pockets of other customers who do not enjoy the benefit of the competition and are charged much higher rates. Then we have the worst forms of discrimination. Sometimes the money cannot be obtained from any customers at all. Then we have bankruptcy, ruin to the investor, and—when these things happen on a large scale—a commercial crisis.[2]

The Forms of Railway Competition

VARIETIES OF COMPETITION IN TRANSPORTATION

Railway competition, or rather competition in transportation, assumes many forms. There is competition between parallel railway lines; between railways and river, canal, or ocean carriers; between railways serving the shipper and consumer by the shortest or most direct route and railways or other carriers serving the shipper and consumer by indirect, circuitous, or roundabout routes; between service or facilities furnished by differ-

[2] A. T. Hadley, *Railroad Transportation*, 73-74.

ent railways or other carriers; between different cities seeking to establish their superiority as commercial or industrial centers with respect to one another;[3] between different producing centers in this country and abroad seeking to reach the same markets for the distribution of their products. The most important of these forms of competition are competition of routes, including direct rivalry between parallel lines, and competition of markets.

Market or commercial competition involves primarily rivalry between producers and not between transportation agencies. In the words of the Industrial Commission:

> It represents the attempt of rival producers, or of rival jobbers and distributing agents of different sections, to extend their influence throughout a consuming territory. The backbone of the railroad adjustment throughout the United States lies in the rivalry between the Atlantic or eastern trade centers and the western cities for the remunerative trade of the southern states. The Texas market is competed for by all the distributive centers between Kansas City and Boston. The fruit-growers of California and of Florida are respectively competing for markets throughout the United States, and particularly in the northeast. Such competition recognizes no national bounds. Copper from Montana must be transported at rates which will permit of meeting the price on Chile bars in the Liverpool market. Our entire grain and cotton crops must be transported at rates which will enable them to hold their precedence in Europe. The cotton-mills in New England and in the South must have their output carried to China under conditions which will enable them to meet the price made by the British manufacturer.[4]

[3] A witness before the Industrial Commission thus tersely described the competition of cities: "It is a continual struggle between the line from Kansas City to St Louis with no interest in Chicago, and the line from Kansas City to Chicago with no interest in St. Louis."—*Report of Industrial Commission*, Vol. 19, p. 357.

[4] *Ibid.*

COMPETITION OF MARKETS AND COMPETITION OF ROUTES

The existence of market competition is a fundamental factor in the adjustment of the American rate structure. The recognition of its importance underlies the general disregard of distance which characterizes our railway rates, and it is the basis of the thousands of special or commodity tariffs under which about three-fourths of our railway traffic is carried. The influence of market or commercial competition is both vital and permanent in the administration of railway enterprise. But it is the attempt of the public to establish permanent competition between transportation agencies, as it appears in the indirect rivalry of competing routes and especially in the direct competition of parallel lines, which presents the chief problem in railway competition from the standpoint of railway regulation. It is with this aspect of competition, and the attitude of the state toward it, that we are here chiefly concerned, for such maintenance of competition by the government runs counter to the natural tendency to co-operation by the railways.[5]

Railway Co-operation and Consolidation

AGREEMENTS TO MAINTAIN RATES

We have seen that railway competition leads to unrestrained rivalry, harmful alike to the railroads and to the public. To safeguard themselves against the evils of abnormal competitive conditions, the railways have resorted to various methods of co-operation. The first

[5] The practical importance of the various forms of competition in the development of the rate structures in this country is well explained in the treatises on Freight Rates, Official, Southern, and Western territories, respectively, which are a part of the course in Interstate Commerce and Railway Traffic.

and simplest of these methods was the agreement to maintain rates. Under these agreements the struggle for traffic continued as before, each railway securing as much business as possible, but the expedient of rate-cutting could not be resorted to as a means of obtaining increased traffic. In so far as these agreements to maintain rates were enforced, therefore, the competitive emphasis was shifted from rates to service. But for the most part this method of co-operation proved ineffective, for the incentive to break the agreements, and thereby increase net revenues unduly, was very strong, and enforcing machinery, legal or administrative, was entirely lacking.

POOLING ARRANGEMENTS

The next method of co-operation resorted to by the railways was the pooling agreement. Its essential characteristics have been described as follows:

> A railroad pool is nothing more nor less than an agreement among the several parties concerned that each will accept a certain percentage of the entire traffic, which shall be guaranteed to it by the other roads. This guarantee obviates at once the necessity for urgently soliciting business by cutting rates, and at the same time it nullifies the threat of the large shipper to divert his tonnage from a road which refuses to grant him such concessions as he sees fit to ask.[6]

The object of the railway pools was to prevent the cutting of rates and to establish such conditions as would enable the railroads to maintain stable and reasonable charges. These pools were of two kinds, (1) traffic pools and (2) money pools.

In the traffic pools each member of the agreement was guaranteed a definite percentage of the business, this per-

[6] *Report of Industrial Commission*, Vol. 19, p. 331.

centage being based upon the average traffic of the given carrier over a period of years. If one railroad failed to secure its allotted proportion of traffic, enough tonnage was diverted from other railroads, which carried more than their allotted percentage, to satisfy the original apportionment. The operation of these traffic pools, involving the diversion of freight from one road to another, vested in the railroads the power of determining the routing of goods and not infrequently aroused the opposition of shippers. Pooling agreements whereby the revenue from operation rather than the business itself was apportioned on an agreed basis were therefore more usually relied upon.

In the money pools each member of the agreement was guaranteed a certain percentage of the revenue accruing from the business pooled, this percentage, as before, being based upon the normal traffic of the given carrier over a period of years, and not upon the actual amount of business done during the life of the agreement. From the gross revenue of each road an amount varying from 20 to 50 per cent was deducted as an allowance for the cost of conducting transportation, and the remainder was turned into the pool for distribution in accordance with the fixed apportionment. The disinclination of roads earning more than their allotted percentages to turn this excess into the pool for the benefit of the less successful roads was largely overcome by the requirement that railroads should deposit in advance an amount of money from which the necessary adjustments might be made.

Although there was some temptation to violate the pooling agreements by cutting rates, in order that a road's increased business might strengthen its claim for a larger percentage of the traffic or revenue when the time for reapportionment came, this method of railway

co-operation was wide-spread and effective. During the seventies practically every important railroad in the United States was allied with some kind of pooling organization. The transition from this type of organization to the present forms of combinations may now be traced.

THE IMPETUS TO CONSOLIDATION

The superiority of the pool over the simple agreement to maintain rates lay chiefly in the administrative machinery which it provided for the enforcement of its provisions. From the legal standpoint pooling agreements were as invalid and unenforceable as simple agreements to maintain rates. The effectiveness of both of these methods of co-operation was dependent upon the honor of the parties to the agreement, the courts refusing to lend the authority of the state in aid of their enforcement, on the ground that they were contrary to public policy.

When, therefore, as we shall see in succeeding paragraphs, pooling was prohibited by the Act to Regulate Commerce, and agreements to maintain rates were construed as falling within the condemnation of the Sherman Anti-Trust Act, competing railways were forced to resort to unity of management and control as a means of securing the necessary co-operation. There is hardly any question that the movement toward actual consolidation, which became so rapid after 1898, was substantially hastened by the attitude of the law toward the simpler and less formal methods of railway co-operation. What, then, more concretely, is the attitude of the law toward railway competition and what efforts were made by the carriers to avoid its pitfalls?

The Legal Validity of Co-operative Effort

PUBLIC DISTRUST OF MONOPOLY

From the earliest times, English thought has looked upon private monopoly as prejudicial to public welfare, and the common law has discouraged all arrangements tending to establish or to strengthen private monopoly. This attitude has been uniformly enforced by our American courts. Contracts in restraint of trade, therefore, in so far as they tend to substitute the arbitrary arrangements of producers and sellers in the determination of the level of prices and the quality of service in place of the normal competitive forces, have been held illegal and unenforceable. Such contracts are considered contrary to public policy and are therefore made invalid by the illegality of their object. But, while the courts would not lend their aid in the enforcement of such agreements or arrangements, there was no express prohibition of such contracts, with penalties to be imposed upon those entering into them. In other words, there were no positive legal obstacles to the formation of such contracts, but in their enforcement reliance had to be placed upon the honor of the individuals and the deposit of forfeitures, rather than upon the ordinary legal machinery. As one court expressed it, "We shall decline enforcing such contracts. If parties see fit to invest money in such ventures, they must get it back by some other than legal measures."[7]

It was by these principles of common law that the legality of agreements to maintain rates and pooling arrangements was originally tested. These methods of co-operation could be entered into freely, although no legal remedy was available against those individuals or

[7] Raymond v. Leavitt, 46 Mich. 447.

corporations who saw fit, from motives of private interest, to violate the terms of their undertakings. The pool was resorted to more frequently than the simple agreement, but merely because of its superior administrative effectiveness. This was the situation to 1887 when the Act to Regulate Commerce was passed by the federal government.

THE PROHIBITION OF POOLING

The Act to Regulate Commerce made pooling illegal in a much wider sense than it had been at common law, for it actually prohibited such arrangements instead of merely considering them invalid as theretofore. Section five of the Act provides "that it shall be unlawful for any common carrier subject to the provisions of the Act to enter into any contract, agreement or combination with any other common carrier or carriers for the pooling of freights of different and competing railroads, or to divide between them the aggregate or net proceeds or the earnings of such railroads, or any portion thereof."

The pooling agreements that were so wide-spread up to 1887 had been carried out very largely through traffic associations organized in all parts of the country. These traffic associations now had to be reorganized in such fashion as to eliminate the pooling features prohibited by the fifth section of the Act. Since, however, co-operation between competing railways was still deemed necessary because of the very nature of the railway business, these associations began to revert to mere rate agreements, without the added administrative safeguards to be derived from the actual pooling of freight or revenue.

Prior to 1887, then, both pools and simple agreements had been allowed; after 1887 pooling was prohibited, but agreements to maintain rates were still considered lawful.

This situation continued for a decade. A decision of the Supreme Court bringing railroads under the prohibitions of the anti-trust act then deprived them also of this method of co-operation.

THE RAILROADS AND THE SHERMAN ANTI-TRUST ACT

The Sherman Anti-Trust Act, passed in 1890, declared "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states or with foreign nations" to be illegal. It was generally believed that the Sherman Act had been passed for the purpose of arresting the so-called trust movement, and that its provisions were therefore applicable merely to industrial or business corporations. The question whether railroads fell within the scope of the Act was definitely settled in the affirmative by the Supreme Court of the United States in the Trans-Missouri Freight Association [8] and Joint Traffic Association [9] cases decided in 1897 and 1898.

In the Trans-Missouri Freight Association case there was an agreement among eighteen railroads whereby an association was created and methods were provided for fixing the rates and fares on competitive interstate freight traffic south and west of the Missouri River. The Association was declared to have been created, among other things, "for the purpose of mutual protection, by establishing and maintaining reasonable rates." The two lower courts, the Circuit Court and the Circuit Court of Appeals, upheld the legality of the arrangement; but the Supreme Court, by a five-to-four decision, declared the Trans-Missouri Freight Association, in view of its purposes, to be organized in violation of the Sherman Anti-Trust Act.

[8] United States v. Trans-Missouri Freight Association, 166 U. S. 290.

[9] United States v. Joint Traffic Association, 171 U. S. 505.

Two important principles were thus established by the court; first, that the anti-trust act applied to railroads as well as to industrial corporations; and second, that all contracts in restraint of trade or commerce among the several states or with foreign nations, whether reasonable or unreasonable, were prohibited by the Act.

In the Joint Traffic Association case there was an agreement among thirty-two railroads whereby an association was created and methods were provided for fixing the rates and fares on competitive interstate traffic east of Chicago. In this case, too, the expressed purpose of the Association was to establish and maintain "reasonable and just" rates and fares. The Supreme Court confirmed the decision of the Trans-Missouri case: railroads were held subject to the Act and the reasonableness or unreasonableness of the restraint was declared to be immaterial. The Court said (p. 575): "The natural, direct, and immediate effect of competition is to lower rates, and to thereby increase the demand for commodities, the supplying of which increases, and an agreement, whose first and direct effect is to prevent this play of competition, restrains instead of promoting trade and commerce."

As a result of these cases, co-operative action on the part of the railroads in fixing and maintaining rates, even without resort to actual pooling arrangements, was made unlawful. It was this legal situation which lent substantial impetus to the process of consolidation which marked the years of prosperity at the close of the nineteenth century.

Government Regulation and Railway Co-Operation

In their interpretation of the Sherman Anti-Trust Act the courts have exercised their authority against unlaw-

ful restraint of trade or monopoly, regardless of the method or form of organization by means of which the prohibited practices were employed. Actual consolidation between competing railway lines has thus been no less effectively condemned than the looser agreements of the traffic associations.

The most important and widely known examples of the exercise of this power by the courts are the dissolution of the merger of the so-called Hill lines through the Northern Securities Company and the dissolution of the merger of the so-called Harriman lines through the Union Pacific—Southern Pacific combination. In the first case, the Northern Securities Company was a holding corporation through which the direct competition between the Great Northern and the Northern Pacific companies was to be eliminated. In the second case the less direct competition between the Union Pacific and the Southern Pacific railroads, as well as their subsidiaries, was to be eliminated by a merger of the two through the purchase by the Union Pacific company of a controlling interest in the capital stock of its competitors. In both cases a dissolution was ordered on the ground that the consolidation violated the prohibitions of the anti-trust act against restraint of trade and monopoly. The resulting inability of competing railways to consolidate their enterprise emphasizes the more strongly the need of allowing the railways to resort to the methods of co-operation which are prohibited by the anti-pooling section of the Act to Regulate Commerce.

We have seen that unrestrained competition is ruinous to the railways and harmful to the public. To prevent the instability of transportation charges which springs from general rate-cutting and the manifest evils which result from discriminatory practices, railway co-opera-

tion is necessary. With the extensive powers of control now vested in the Interstate Commerce Commission and in the state railroad or public service commissions there is little danger that the legalization of pooling would lead to excessive charges.

There is an almost unanimous demand, therefore, on the part of commissions, publicists, and students of railway economics, as well as by the railways themselves, that the anti-pooling section of the Interstate Commerce Act be repealed. If the state is to prevent effectively the evils of rate wars and unjust discriminations, pooling arrangements and agreements as to rates must be recognized as lawful. To prohibit all forms of co-operative effort in the adjustment of rates on the part of competing railways is to intensify one of the fundamental causes of the evil sought to be eradicated. "The law undertakes to enforce two lines of policy which will not run together so long as different railroads act as carriers for the same territory." [10]

Moreover, we find at the present time that in spite of the fact that co-operation between carriers is for the most part illegal, the railroads have found it absolutely essential to work together by means of voluntary co-operative associations. It is everywhere conceded that much is gained on all sides from the operation of these associations. If American railways are to perform their functions properly, the activities of these associations must receive full legal recognition, and the scope of their co-operative effort must be substantially extended.

[10] H. R. Seager, *Introduction to Economics* (3d ed.), 470.

TEST QUESTIONS

1. Mention several of the common forms of competition in transportation.
2. How does railway competition compare with industrial competition?
3. What is meant by a railroad pool?
4. Explain two kinds of railroad pools.
5. What causes made rate agreements and pooling arrangements ineffective in eliminating the evils of competition?
6. What events have led to the extensive consolidation of railways which have taken place in recent years?
7. How does the Sherman Anti-Trust Act affect co-operation of carriers?
8. Why should pooling arrangements and rate agreements of carriers be made lawful?

CHAPTER V

THE THEORY AND PRACTICE OF RATE-MAKING

Rates and Regulation

The question of rates, which we are now to discuss, is rightly regarded as the heart of the railway problem. It is through the adjustment of rates that the tremendous power of the railways is wielded for good or for ill, and it is in connection with the making of rates that the greatest railway evils and abuses—those which vitally affect the industrial, social, and political welfare of the country—have arisen. The elimination of these evils is the chief object of the elaborate system of government regulation which has been built up in this country, and a discussion of regulation must concern itself primarily with the problem of rates. It is true that questions of service and of finance must not be neglected. The interrelationship between rates, service, and finance has been succinctly stated as follows:

> The transportation problem has three vitally important factors: (1) rates, (2) service, and (3) financial return. Neither can be intelligently or equitably considered except with reference to the other two. The railway has a right to exact, and the public to require, fair and reasonable rates; but what are such rates depends largely on the service given for them and on the financial return received by the owners of the railway. The public has a right to demand safe, convenient, and adequate service; but how safe, convenient, and adequate a railway can make its service

depends largely on its financial return, and this on what rates it can charge. The owners of the railways are legally entitled to a "fair return," but this right is not absolute; it is conditioned on what kind of service is given and at what rates.[1]

But while it is obviously necessary, in an adequate discussion of the rate problem, to keep in mind the interdependence of rates, service, and return, the success or failure with which a railway performs its public functions appears most clearly and most directly in the adjustment of its rates, and it is through a discussion of rates that the heart of the railroad problem may be most successfully reached.

Theories of Rate-Making

Cost of Service and Value of Service

There are two prevailing theories as to the principles upon which railway rates shall be based. One is that rates should equal the *cost of the service,* including a reasonable profit to the railway company; the other theory is that rates should be determined in accordance with the *value of the service* to the passenger or shipper. The general contrast between these two theories is thus described by Professor Ripley:

> These two principles of cost of service and value of service are directly opposed in one regard; for the cost-of-service theory harks directly back to railway expenditure, while the value-of-service principle contemplates primarily the effect upon the railway's income account. According to the latter view, any charge is justified which is not detrimental to the shipper, as indicated by a positive reduction in the volume of business offered. No charge, on the other hand, may be deemed reasonable according

[1] S. O. Dunn, *The American Transportation Question,* v.

to the cost-of-service principle, which affords more than a fair profit upon the business, regardless of its effect upon the shipper.[2]

COST OF SERVICE: DESIRABILITY

At first sight the cost theory, usually advocated by the public and sometimes by the shippers, seems eminently entitled to approval and acceptance, inasmuch as it complies with the requirements of reasonableness which we commonly recognize in ordinary business. In discussing, for example, the price of a manufactured article, most people agree that if it is possible to find a fair price at all, that fair price is one which equals the cost of production, including in cost of production a reasonable profit to the *entrepreneur* [3] as well as reimbursement for actual expenditure. This reasoning is not applicable to the adjustment of railway rates in our present industrial system. Striking evidence is presented of the peculiar economic character of the railway business and of the very special and vital relation which it bears to the public welfare, when we observe the result of applying the cost-of-service principle to railway rates.

It happens that many of the most necessary articles of commerce and of personal consumption—such, for example, as wheat, corn and other food products, lumber, iron ore, coal, oil, furniture and similar commodities—are heavier and bulkier in proportion to their value than many of the higher-priced luxuries now consumed—such, for example, as jewelry, lace, wines, and the like. Since

[2] W. Z. Ripley, *Railroads: Rates and Regulation*, 167.

[3] There is no single English word which will render adequately the meaning of this French term. It comes from the verb "entreprendre," which means to "undertake," "engage in an enterprise." Some writers use "enterpriser" for the French word. "Dealer" and "tradesman" sometimes render it well enough. In the present instance "manufacturer" or "producer" expresses its meaning most accurately.

weight and bulk increase the cost of carriage, the first named necessaries would, on the cost principle, be compelled to bear very high rates, while luxuries and commodities providing the mere comforts of individuals would be transported at low rates. If necessaries were to be shipped, therefore, the high cost of transportation would enhance their prices so decidedly as to discourage consumption and react upon production. Obviously a system of rate-making the general effect of which would be to discourage the production and use of the necessaries of life, and at the same time to stimulate the production of luxuries, would be inimical to the public welfare.

Moreover, what is of even greater importance, such a rate adjustment would minimize the extent of large-scale production and deprive the public, to a large degree, of the advantages of the territorial division of labor. The practicability of large-scale production is dependent fundamentally upon an extensive market, and the territorial division of labor depends very largely upon the possibility of procuring raw materials and food products at low rates of transportation. A rate adjustment on the principle of cost of service would narrow the market and raise notably the prices of raw materials and food products.[4] The Interstate Commerce Commission, in its first annual report, in rejecting the cost-of-service theory as the sole basis of rate-making, emphasizes the fact that it "would restrict within very narrow limits the commerce in articles whose bulk or weight was large as compared

[4] "The phenomenal industrial advance of the last twenty-five years has been made possible by the low transportation rates on food products and the materials of industry; and these low charges would not have been possible, had not the articles of higher value per bulk paid more than their proportionate share of the total expenses of railroad transportation."—E. R. Johnson, *American Railway Transportation* (2d ed.), 274.

with their value."[5] It is to be noted, however, that the Commission has shown a marked tendency in recent years to give great weight to the cost-of-service principle as one of the factors in the adjustment of the railway rate structure.[6]

COST OF SERVICE: PRACTICABILITY

But the cost-of-service principle, even if desirable, could not be relied upon as a sole basis for the adjustment of railway rates, because, as we have seen in an earlier chapter, it cannot be applied in practice. So large a proportion of railway expenditures are constant that most railway services are rendered at joint cost. It is entirely impracticable, therefore, to ascertain the exact cost of any particular service. A railroad cannot charge its shippers or passengers a sum equal to the cost of the service each receives, because it is impossible to determine what the cost of a given haul will be or has been, and it is equally impossible to estimate with mathematical accuracy the expense involved in carrying a passenger between any two points. The cost theory, then, however useful it may be as *one* element in determining the reasonableness of rates, cannot by itself be employed as a general and comprehensive principle of rate adjustment.

In one of the earliest cases coming before it for adjudication, the Interstate Commerce Commission recognized the impracticability of using cost of service as a *sole* basis of railway rates.

> While cost, as has been said, is an element to be taken into account in the fixing of rates and one of the very highest importance, it cannot, for reasons well understood, be made the rate

[5] *First Annual Report of the Interstate Commerce Commission,* 30-32.

[6] This gradual change of policy is discussed in C. R. Hillyer, *Grounds of Proof in Rate Cases,* 10.

basis, but it must in any case be used with caution and reserve. This is not merely because the word "cost" is made use of in different senses when applied to railroad traffic, it being often used to cover merely the expense of loading, moving, and unloading trains, but also because in whatever sense the word be used, it is quite impossible to apportion with accuracy the cost of service among the items of the traffic. Any attempt to apportion the cost would at the best and under the most favorable circumstances only reach an approximation.[7]

VALUE OF SERVICE: SIGNIFICANCE

The principle that rates should be determined in accordance with the value of the service to the passenger or shipper is generally advocated by the railways and is usually followed in practice. The phrase, "value of service," is often taken to be equivalent to "charging what the traffic will bear," but its meaning or significance is not always clear or definite.

By "value of the service" is not meant, for example, that the railroad should charge each passenger or shipper according to the subjective value of the particular service

[7] *In re* petition of Louisville & Nashville Railroad Company, 1 I. C. C. Rep. 31; 1 I. C. R. 238. It is to be noted, however, that the Commission has nevertheless used cost of service "as a means of determining the reasonableness of rates in four different classes of cases: (1) when a rate higher than the ordinary could be justified on the ground that some special service had been performed or a special obligation incurred by the carrier; (2) where a rate complained of was judged as to its reasonableness by comparing the *ascertainable* costs of transportation with those incurred in transporting other commodities whose rates were believed to be reasonable; (3) where comparison was made with costs on other roads or on other parts of the system; (4) where the costs of shipping commodities in car-load lots were compared with those incurred in shipping less than car-load quantities. By methods of comparison, therefore, rather than by attempting to ascertain the exact and total costs of transporting a given commodity, the Interstate Commerce Commission has made use of the cost-of-service principle as applied to railway rates."—M. B. Hammond, *Railway Rate Theories of the Interstate Commerce Commission*, 44 *et seq.*

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to him, that is, the value which in his own mind he attributes to the given service. If this meaning were attached to the value-of-service principle, it would be even more impracticable and less desirable as a basis for rate-making than the cost-of-service theory; for, in the first place, it would be absolutely impossible to determine this subjective value in each individual case, and, furthermore, if subjective values could be measured, the grossest personal distinctions and discriminations would result. The care-free excursionist to whom a trip from Chicago to New York is worth only ten dollars would be charged that sum, while the merchant or broker to whom such a journey is essential to some important business transaction might justly be charged a hundred times that amount on the basis of the subjective value of the service to him. Such an interpretation of the meaning of value of service would neither explain the existing system of rate adjustment nor suggest an improvement thereon.

The usual meaning of the value-of-service principle is that it measures the added value given to commodities as a result of their being transported from one place to another. Differences in the price of the same commodity in different markets indicates the extent of the added value resulting from the transportation of that commodity. The value of carrying an article, for example, from Grand Rapids to Omaha, the price of the article being $15 in Grand Rapids and $16 in Omaha, would be $1.

This method of measurement cannot be applied thus definitely to the passenger traffic. The value of the service to the passenger must be ascertained through experiment. A rate which tends to decrease the normal traffic is probably above the value of the service; a rate which tends to increase the normal traffic is probably below the value of the service to the marginal passenger.

In practice, it is through some such experimentation, often unconscious, that the value of the service in freight traffic as well as in passenger traffic is determined. The adjustment of rates, then, on the basis of value of service, or by charging what the traffic will bear, comes to mean the establishment of such rates as will not discourage or reduce the shipment of freight and will not discourage or decrease the demand for passenger service.

Value of the service, as distinct from cost of service, has in the past been accepted by the Interstate Commerce Commission as a fundamental principle of rate-making. In its first annual report the Commission declared that "such method of apportionment would be best for the country, because it would enlarge commerce and extend communication; it would be best for the railroads, because it would build up a large business; and it would not be unjust to property owners, who would thus be made to pay in some proportion to benefits received."[8] As already suggested, however, the Commission now gives greater emphasis to cost of service than formerly.

In this same report, the Commission recognizes, what is generally accepted by the railways as a working rule, that the relative value of commodities constitutes the chief factor in the determination of the value of the service to the shipper, "that the value of the article carried is the most important element in determining what shall be paid upon it."[8] The general result of this method of rate adjustment is that the charges on commodities which are cheap in proportion to weight or bulk are low, while the rates on the lighter but more expensive goods are high.[9] In like manner the rates on competitive traffic are

[8] *First Annual Report of the Interstate Commerce Commission*, 30-32.

[9] A ton of coal is worth at the mine, perhaps, $1.50. A ton of shoes is worth at the factory, perhaps, $1,500. Coal moves in car-loads of 40 tons

uniformly lower than the rates at non-competing points. This disregard of distance, too, is but an application of the value-of-service principle to the adjustment of railway rates.

It is to be noted, moreover, that this principle is adopted on the basis of purely economic considerations. Charging what the traffic will bear does not mean that railway charges for different categories of traffic are fixed on the principle of equality of sacrifice by the payer, in order that equitable concessions may be made to the weaker members of the community; or that the problem of rate adjustment is at bottom one of ethics, involving those considerations of public policy and of right and wrong which recur in the discussions of proportional or progressive taxation.[10]

The classification of freight and the adjustment of the railway tariff on the basis of what the traffic will bear are due fundamentally to the fact that railway service is rendered so largely at joint cost. The result of the adjustment may possess an ethical significance; the motive for the adjustment is purely economic. It is because from one-half to three-fourths of all the expenditures of a railway are joint and constant that railway charges must be so adjusted as not to discourage the shipment of freight or decrease the demand for passenger service.

or more; therefore, a car-load is worth about $60. Shoes move in car-loads of perhaps 10 tons; therefore, a car-load is worth about $15,000. There would not be much difference between the direct costs of hauling the car-load of coal and the car-load of shoes. But does it not appeal to equity and common sense that the car-load of coal, which is worth $60, should be given a lower rate per ton per mile, or even per car per mile, than the car-load of shoes, which is worth $15,000?—S. O. Dunn, *The American Transportation Question*, 25.

[10] The most able discussion of this problem is to be found in F. W. Taussig, "A Contribution to the Theory of Railway Rates," *Quarterly Journal of Economics*, Vol. 5, pp. 438-65.

VALUE OF SERVICE: ADEQUACY

The value-of-service principle, as a sole basis of railway rates, is as inadequate for the protection of the public interest as the cost-of-service principle, by itself, is undesirable from the standpoint of public welfare. The relation of rates, as between different classes of traffic and as between competitive and non-competitive points, may well be determined, and in practice largely is determined, by charging what the traffic will bear; but the propriety of the general level of rates, the reasonableness of rates in and of themselves, cannot be assured by the mere adoption of the value-of-service principle. Unreasonably high rates do not automatically and immediately discourage the shipment of goods or the use of the railway service, for the burden of excessive rates does not rest upon the shipper, being immediately shifted in most cases to the consumer. Moreover, the consumer, on his part, is not always and at once influenced by excessive rates, because his demand is inelastic in the case of necessaries—he must have them even at excessive cost—and in the case of the higher-priced goods the cost of transportation, even when rates are unduly high, does not constitute a very substantial part of the total price of the product.

In support of the inadequacy of the value-of-service idea as a check upon unreasonably high rates, Professor Ripley presents much striking evidence taken from the claims of the railways themselves. Because this evidence is so convincing, it is quoted somewhat at length. Professor Ripley writes:

> That the principle of charging what the traffic will bear affords no protection to the consumer against exorbitant rates on many commodities, follows also from the relative insignificance of

transportation charges as compared with the value of the goods. This, in fact, was naïvely conceded by railway managers themselves, when, as in the case of the wide-spread freight rate advances of 1908-1909, publicity agents flooded the country with calculations as to the infinitesimal fraction which would be added to the price of commodities by a ten per cent rise in rates. The rate from Grand Rapids to Chicago on an ordinary dining-room set of furniture being $1.60, a ten per cent increase would add only sixteen cents to the cost. A harvester transported one hundred miles would be enhanced seventeen and a half cents in price; a kitchen stove carried from Detroit to the Mississippi would only cost twenty-five cents more; and the price of a Michigan refrigerator sold in New York would be only seven and one-half cents higher, were freight rates to be increased by ten per cent in each instance. On wearing-apparel the proportions were represented as even more striking. An ordinary suit of clothes transported three hundred miles under similarly enhanced rates would, it was alleged, cost only one-third of a cent more. For all his apparel made in New England, consisting of everything from hats to shoes, a ten per cent rise of rates would affect each wearer in the Middle West by less than one cent. True enough all this, and a striking testimonial to the effectiveness of the railway service of the country; but at the same time, if a ten per cent increase of rates is inappreciable to the consumer, why not increase them by twenty per cent? And what becomes of the argument that charging rates according to what the traffic will bear is an ample safeguard against extortion? Many of these small changes in price are diffused in the friction of retail trade; some of them are unfortunately magnified to the consumer, especially under conditions of monopoly. When freight rates on beef go up ten cents per hundredweight, the consumers' price is more likely than not to rise by ten times that amount. But even assuming the final cost to follow the range of transportation charges closely, is it not evident that many freight charges are so small relatively by comparison with other costs of production, that consumption is not proportionately affected by their movement one way or the other?

And yet the entire argument that the value-of-service principle is a self-governing engine against unreasonable rates is based upon the opposite assumption. Surely the increased income to the carriers when rates are raised must come from some one! Because it is not felt is no reason for denying its existence as a tax. But the very fact that it is not felt undermines the argument that a safeguard against extortion obtains. The theory that value of service in itself affords a reliable basis for rate-making, presupposes that freight rates and prices move in unison —a supposition which a moment's consideration shows to be untenable in fact.[11]

SOCIAL CONSIDERATIONS

Both cost of service and value of service must therefore be considered in the adjustment of railway rates. It is generally recognized that cost of service, in the sense of the extra or "out-of-pocket" cost in case of a specific service and in the sense of the total cost in case of the traffic as a whole, fixes the lower limit of rates; while value of service fixes the upper limit beyond which the specific rate or the general level of rates cannot go. The reasonable, or intermediate, rate must be determined, and under our system of government regulation generally tends to be determined, by the application of social considerations or by the demands of public welfare. These considerations of public interest are numerous and to a large extent undefined. A comprehensive and logical social theory of rates can hardly be evolved until there is a clearer understanding and a greater agreement in the community as to its ends and purposes. But in general terms many of these social considerations may be defined.

A system of rates fixed with reference to public welfare should be so adjusted as to stimulate industrial

[11] W. Z. Ripley, *Railroads: Rates and Regulation*, 171-73.

enterprise, to develop as well as conserve natural resources, to provoke and maintain fair and healthy competition in the world of business, and to facilitate the movement of labor. It should encourage the settlement of new land, discourage undue congestion of population in the large cities, enlarge the opportunities of rural life, promote political unity, stimulate intercourse between different parts of the country, and help attain such other ends as the community's interest may demand.

The specific adjudications of the Interstate Commerce Commission are not infrequently based upon considerations of public welfare, sometimes expressly mentioned, more often tacitly implied. In accepting the value of the commodity as a basis of the reasonableness of the rates applicable to different categories of traffic, the Commission often adduces social considerations in support of its position. In justifying the establishment of low rates on iron and steel products the Commission said:

> While some of the relatively low rates on low class commodities, including iron and steel, are lower because of competition by water than they would otherwise be, the general comparatively low rating applied to them is largely due to the character of such commodities, the use to which they are put, the demand for them in large quantities throughout the country, their susceptibility of movement at less cost and risk to the carrier than high class and more valuable freight, and other like conditions. It is to the interest of the carriers as well as the public that their rates be low enough, if not below a remunerative point, to permit the general movement and distribution of these commodities in general demand in larger quantities for construction, building, manufacturing, and other purposes. Reasonable freedom of such movement and distribution stimulates the growth and development of the country and thereby promotes all interests.[12]

[12] Colorado Fuel & Iron Company v. The Southern Pacific Company et al., 6 I. C. C. Rep. 264.

Rate-making Practice [13]

The principles under discussion in the preceding pages are applied in practice, to a greater or smaller extent, in the classification of freight and in the adjustment of tariffs.

The classification of freight

Every well-developed system of rate-making is based upon the classification of freight. The articles of commerce usually or occasionally offered for transportation are so numerous that it would be practically impossible to assign a separate rate to each; on the other hand, as we have seen, it would be clearly unwise to charge the same rates for all commodities. The desirability of avoiding undue complexity in the rate structure, and at the same time of distinguishing between various kinds of goods, creates the necessity of grouping commodities into classes and fixing rates for each class.

At the present time there are three principal classifications in the United States: the Official, the Southern, and the Western. Roughly speaking, the Official Classification governs the territory north of the Ohio and Potomac rivers and east of the Mississippi; the Southern Classification applies to the region east of the Mississippi and south of Official Classification Territory; the Western Classification is in use throughout the remainder of the country.[14] Each of these classifications is in charge of a committee consisting of the traffic officers of the lead-

[13] This subject is treated here very briefly and in most general terms. It is considered in exhaustive detail in the more technical treatises on classifications and rates which constitute part of the course in Interstate Commerce and Railway Traffic.

[14] These boundaries are very general in their nature. Each of the classifications often governs traffic into territories ordinarily governed by other classifications.

ing roads affected by the classification. In addition to these three leading classifications, ten of the states maintain by law special classifications for intra-state traffic.

The number of separate items covered by each classification is very large, the Official Classification, in which the greatest number appears, containing about ten thousand different descriptions of traffic. The Official Classification describes six regular classes, designated by the numbers one to six, inclusive, and three classes made by prescribed formulas; the Southern Classification has thirteen classes, designated by the numbers one to six and by the letters A to H (G being omitted); the Western Classification embraces ten groups, designated by the numbers one to five and by the letters A to E. Moreover, many articles are rated in exceptional ways: such, for example, as one and one-half times first class, double first class, four times first class, fifteen per cent below second class, twenty per cent below third class, and so forth. Furthermore, many commodities of special importance within the territory served by each railroad are entirely withdrawn from classification and are carried at special rates. In addition, therefore, to the class tariffs each road has commodity rates for such goods as live stock, dressed meats, grain and grain products, lumber, iron, coal, oil, and the like.

The value of a commodity, as compared with its bulk and weight, constitutes, as we have seen, the fundamental basis for classification; but numerous other factors, the most important of which is the cost of service, exert an important influence in the grouping of commodities. Some of these considerations were stated by the Interstate Commerce Commission in 1897 as follows:

Whether commodities were crude, rough, or finished; liquid or dry; knocked down or set up, loose or in bulk; nested or in boxes, or otherwise packed, if vegetables, whether green or dry, desiccated or evaporated; the market value and shippers' representations as to their character; the cost of service, length and direction of haul; the season and manner of shipment; the space occupied and weight; whether in carload or less-than-carload lots; the volume of annual shipments to be calculated on; the sort of car required, whether flat, gondola, box, tank, or special, whether ice or heat must be furnished; the speed of trains necessary for perishable or otherwise "rush" goods; the risk of handling, either to the goods themselves or other property; the weights, actual and estimated; the carrier's risk or owner's release from damage or loss.[15]

In an important case[16] involving the relative rates upon live hogs and dressed beef and hog products, the Commission laid primary stress upon the relative costs of rendering the service, as is evidenced by its conclusions, stated as follows:

(1) The product is carried in more expensive cars. * * * The interest on the increased original cost and the greater outlay for repairs are constant expenses. (2) The weight of the refrigerator car, when loaded with the product, including the ice for refrigeration, is about 64,000 pounds, and that of the live stock car when loaded is 46,000 pounds. If the tariff were based solely upon tonnage, that is, upon the weight of the car and its load when the carrier charges 30 cents per hundred for carrying the live hogs, the charge for carrying the product should be about 42 cents per hundred. (3) The loading and unloading of the animals by the shipper instead of the carrier is a continuing advantage. (4) The rapidity with which the cars used in the live-stock traffic are loaded render them less liable

[15] *Eleventh Annual Report of the Interstate Commerce Commission*, 67.

[16] John P. Squire & Co. v. The Michigan Central Railroad Co. et al., 4 I. C. C. Rep. 611; 3 I. C. R. 515.

to detention, and they are returned to the traffic sooner than when loaded with the product. (5) The refrigerator cars have to be iced. Five tons of ice and salt per car are furnished in the Chicago-Boston business. This is a constant expense in summer months. (6) The product is more valuable than the live animals.

While the last of these conclusions deals with the value-of-service principle, the Commission makes it clear that it relies upon cost as the fundamental factor in a case of this sort; for, in this same decision, it declares:

> We are of the opinion that, in the fixing of relative rates upon articles strictly competitive, as these are, the proper relation should be determined from the cost of the service, and if the difference in this respect between two competitive articles can be ascertained, such a rate should be fixed for each as corresponds to the cost of service. This is fair to the carrier, and we believe that the manufacturer has a right to demand of the companies that such a relation of rates as to these articles should be maintained.

THE MAKING OF RATES

The railway tariff is distinct from the freight classification. It is issued independently by each of the railways or by tariff-issuing agencies such as the Central Freight Association. It represents a graduation of rates based on the distance each commodity is carried, not on the nature of the commodity. Moreover, whereas the primary criterion for the classification of freight is the value of the service, measured usually by the relative values of the commodities carried, the initial consideration in the adjustment of the freight tariff is the cost of the service as measured by distance.[17] A strict distance tariff, however, would not absolutely reflect the cost of

[17] As will be seen later, in actual practice, distance is often a very small factor.

service principle; in other words, on the basis of cost, rates should not be exactly proportional to distance. The cost of each shipment consists of two elements, the terminal expenses at points of origin and destination such as for loading and unloading, which are the same for both long and short hauls, and the transportation expenses for actual carriage, which alone vary with distance. A fifty-mile haul, therefore, costs more *per mile* than a haul of a hundred miles because the terminal expense is the same in both cases.

The establishment of lower rates for goods shipped in carload lots than for the same goods shipped in less than carload lots is likewise a departure from distance as the sole measure of cost. Minimum carload weights are fixed, varying for different classes of commodities, and for the shipment of goods in such carload lots lower rates per hundred-weight are quoted than those charged for less than carload consignments. The justification for these differences is to be found largely in differences in cost. To use the language of Professor Ripley, "not only the amount of paying freight in relation to dead weight, but the cost of loading and unloading, of billing or collection and of adjusting damages—all of these elements of cost are noticeably less in the case of a full carload." [18]

But even in the adjustment of carload and less-than-carload rates, many considerations beside cost of service exert an important influence upon the result. The nature of existing competition between producing and distributing centers, as well as between producers and jobbers, is largely affected by, and in its turn largely determines, the character and extent of carload and less-than-carload ratings. In like manner the entire rate structure is dependent, in its actual adjustment, upon competition of

[18] W. Z. Ripley, *Railroads: Rates and Regulation*, 326.

routes and competition of markets. In order to meet the competition of circuitous or roundabout routes (not to mention competition by water carriers), and in order to enable producers in different parts of the country and in different sections of the world to compete on equal terms in common markets, the railways must necessarily disregard, to a large extent, the primary element of distance.

In practice, then, the railway tariff, as well as the freight classification, tends to correspond to the value of the service or to what the traffic will bear. There are no invariable rules, formulas, or principles by which rates are made. The pressure of competitive forces and of established business interests exerts the most powerful influence upon the development of the rate structure. Subject to this pressure, the financial welfare of the railway corporations tends to be the controlling consideration in rate-making, in the absence of public control. Under such circumstances, rates are likely to be as high as they can be made without discouraging traffic, where no competition exists, while at competing points they are likely to be reduced as far as is necessary in order to secure traffic.

Without public control, or with inadequate public control, it is inevitable that the adjustment of rates by private corporations should produce many evils and abuses from the standpoint of public welfare, and the history of American railway transportation discloses such evils and abuses in full measure. Unreasonably high rates have often been charged, many unjust discriminations have been made, distressing uncertainties as to rates have existed, and demoralizing rate wars have been conducted. It is not remarkable, therefore, that an extensive system of public regulation has been developed.

The Reasonableness of Rates

There can be scarcely any doubt that railway rates in certain places, at certain times, or on certain commodities have frequently been excessive, but it is very difficult to pass judgment on the reasonableness of the general level of rates. The comparative method is often used in an attempt to show that American railway rates are moderate. Comparisons are made between rates in this country and those abroad, and also between rates now charged and those formerly in effect.

As between foreign countries and the United States, all thorough comparisons lead to the conclusion that American passenger rates are in general higher than those abroad, while freight rates are substantially lower. The results of such comparisons, however, are not conclusive proof of the reasonableness or unreasonableness of the general level of rates.

Differences in rates between different countries often result from differences in industrial conditions. The preponderance of low-class, long-distance freight, for example, which prevails in the United States because of our vast territory and the abundance of our natural resources, inevitably results in low average receipts per ton-mile on American railways, and goes far toward explaining the contrast between the United States and European countries in receipts per ton-mile.

Differences in rates between different countries may also be explained, to some extent, by differences in the service rendered. This is particularly true in the case of passenger rates. Though American passenger rates are much higher than those in Europe, more comfortable and luxurious accommodations and faster transportation are provided in the United States than are common

abroad, while American railways also carry more baggage free than the European railways.

Comparisons between current rates and those charged at various times in the past are likewise inconclusive. That there has been a substantial decline in transportation charges during the past twenty-five years is clearly established. According to official statistics of the Interstate Commerce Commission the average receipts of American railways per passenger mile were 2.349 cents in 1888 and 1.938 cents in 1910, while the receipts per ton-mile fell from 1.001 cents to .753 cent during the same period.

The significance of these figures, however, may be easily overestimated. A decrease in receipts per unit of traffic may occur without any change in rates. Such a result would necessarily follow if low-class traffic were to increase in amount more rapidly than high-class traffic. For example, if a road developed a large coal business, the return per ton-mile would probably show a material decrease if it had previously been carrying high-grade traffic. Under such circumstances the average receipts per unit on the entire traffic would be lowered, even if the general level of rates remained stationary; and in point of fact there has been a decidedly more than proportionate increase in the low-class freight carried by American railways. In like manner, when shipments in carload lots become more common, in comparison with smaller consignments, lower receipts per ton-mile are the natural result; for carload lots are carried at lower rates per ton than smaller shipments, and hence an increase in the proportion of carload to less-than-carload lots necessarily reduces the average receipts per ton-mile.

Moreover, the general development of the country, increasing the density of the traffic, has naturally produced

a reduction in cost of carriage per unit. Between 1888 and 1910 the mileage of American railways increased about sixty per cent, while, roughly speaking, the passenger traffic more than doubled and the freight traffic more than trebled. To offset these tendencies toward a natural reduction of railway rates, other forces have been at work in the direction of their maintenance or increase. The most important of these forces are the greater effectiveness with which railway managers have been able to curb competition, and the undoubted increase in the cost of railway operation arising from the general decrease in the purchasing power of money, which is one of the factors in the increased cost of labor and materials.

The need, then, for public regulation of railway rates does not arise from any conclusive evidence as to the extortionate character of the general level of American rates; it arises, rather, from the very nature of the railway business and from the extreme complexity of the railway rate structure.

TEST QUESTIONS

1. What are the two most important principles upon which freight rates are based?
2. Discuss briefly the cost-of-service theory from the standpoint of desirability and from the standpoint of practicability.
3. Discuss briefly the value-of-service principle in rate-making.
4. How is a system of rates which is fixed with direct reference to public welfare adjusted?
5. What are some of the considerations which affect the classification of freight as specified by the Interstate Commerce Commission?
6. What is the difference between a freight classification and a freight tariff?
7. What are the chief factors considered in the classification of a commodity?

8. Why is a comparison of rates applying in different countries of little value in determining reasonableness?

9. What are some of the reasons why a comparison of current rates with past rates applying in this country is very unsatisfactory?

10. What factors have been instrumental in working for higher rates in this country?

CHAPTER VI

THE REGULATION OF RAILWAY RATES

The Rate-Fixing Power of the States

THE RIGHT OF REGULATION

Aside from the judicial enforcement of the common-law duties of public service corporations,[1] railway-rate regulation has been applied in the first instance through the state legislatures and commissions and through the Interstate Commerce Commission. The primary problem was whether power was legally vested in the state legislatures to control the rates and charges of railway corporations. The question first arose in the so-called Granger cases,[2] involving the validity of the Granger legislation explained in an earlier chapter. The validity of this legislation was upheld at every point.

The first and most important of these Granger cases was Munn v. Illinois, decided in 1876. In this case the constitutionality of an Illinois statute fixing a maximum rate for the storage of grain in elevators in Chicago was involved. The plaintiff, who had been convicted and fined

[1] The common-law duties of common carriers in many of their phases are treated in *The Law of Carriers* by Ralph Merriam, a treatise in the course in Interstate Commerce and Railway Traffic.

[2] Munn v. Illinois, 94 U. S. 113; C., B. & Q. R. R. Co. v. Iowa, 94 U. S. 155; Peik v. C. and N. W. Ry. Co., Lawrence v. Same, 94 U. S. 164; C., M. & St. C. R. R. Co. v. Ackley, 94 U. S. 179; Winona & St. Peter R. R. Co. v. Blake, 94 U. S. 180; Stone v. Wisconsin, 94 U. S. 181.

in the state courts for a violation of the statute, appealed to the federal courts on the ground that the enforcement of the statutory rate would constitute a violation of the Fourteenth Amendment to the Federal Constitution.[3] The constitutionality of the statute was upheld by the Supreme Court, and the same legal principles were applied in the subsequent cases to railway rates.

The fundamental argument of the railways was the sweeping claim that it was not within the scope of legislative power to regulate railway rates. In support of this claim attention was called to the general principles which govern the attitude of our law towards industry: that what a man charges for his goods or services is looked upon as a private matter to be determined by contract between himself and those with whom he deals; and that the state undertakes to respect such contracts and the right to make them, and does not attempt to coerce people in their bargains with each other.

The Supreme Court admitted that these principles prevail in ordinary private industry but insisted upon the rule of law existing from time immemorial that the state is vested with ample power to regulate the charges of public callings or of any business affected with a public interest. Under this principle of law cartmen, ferrymen, hackney coachmen, wharfingers, millers, and others had in times past been held subject to public control. In the course of industrial development new types of business affected with a public interest have emerged, among them the grain elevators and railways involved in these Gran-

3 That part of the Fourteenth Amendment which is involved here and in subsequent parts of this chapter reads as follows: "No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

ger cases. To regulate their rates, therefore, was merely to apply old principles to new conditions.

STATUTORY REGULATION AND CHARTER AUTHORITY

The railways opposed legislative regulation by the states on the further ground that such regulation was a violation of their charter contracts, since the charters invariably granted to railway companies the power to fix their rates and fares, and was, therefore, repugnant to the constitutional provision that no state shall pass any law impairing the obligation of contract. On this issue, too, the Supreme Court upheld the validity of the state legislation. It held that the grant to a railway company of the power to fix its rates did not involve a renunciation by the state of its own superior right of regulation. It is a well-settled rule of law that all grants by the state, and especially grants of immunity, are to be strictly construed against the party to whom such grants are made, and no grant of immunity can be claimed, therefore, unless it is specifically and definitely conferred. In the case of Ruggles v. Illinois,[4] the court held that:

> A railroad company whose board of directors was by the charter authorized to establish rates could not as against a general law of the state exact more than three cents per mile per passenger. . . . The power granted was to determine the rates by by-laws; the power to pass by-laws was limited to such as were not repugnant to the laws of the state, and hence it was held that the by-laws could not fix a greater rate than was permitted by the general legislation; "Grants of immunity from legitimate control," said the Chief Justice, "are never to be presumed."[5]

[4] 108 U. S. 526.

[5] Francis J. Swayze, "The Regulation of Railway Rates under the Fourteenth Amendment," *Quarterly Journal of Economics*, 1912, 389-424.

ADMINISTRATIVE REGULATION

In the Railroad Commission Cases [6] the Supreme Court held that this reserved power of regulation, in spite of prior charter authority to the railways to establish tolls and charges, could be exercised by the state through administrative commissions subsequently established. Chief Justice Waite said:

> The right to fix reasonable charges has been granted, but the power of declaring what shall be deemed reasonable has not been surrendered. If there had been an intention of surrendering this power, it would have been easy to say so; not having said so, the conclusive presumption is there was no such intention.

The doctrine was early established, then, that railway rates are subject to governmental control through direct legislative enactment and through indirect administrative supervision.

The Development of Federal Rate Regulation

THE AUTHORITY OF THE INTERSTATE COMMERCE COMMISSION

When the Act to Regulate Commerce was passed in 1887, there was no question as to the power of Congress to regulate railroads, and no serious doubt as to the constitutionality of the law. The real problem at issue, which was not definitely determined by judicial decision till a decade after the original Act was passed, was the extent of authority conferred upon the Interstate Commerce Commission by the Act to Regulate Commerce.

At this point it is necessary to consider only the rate-making power of the Commission. It is to be noted, at

[6] 116 U. S. 307.

the outset, that the Commission never asserted any right to prescribe railway rates in the first instance. In one of the earliest cases the Commission declared that "its powers in respect to rates is to determine whether those which the roads impose are, for any reason, in conflict with the statutes."[7] And again, in a later case, the Commission said:

> This Commission is not primarily a rate-making body. The carrier is left free to arrange his own tariffs in the first instance. We sit for the correction of what is unreasonable and unjust in those tariffs.[8]

From the very beginning, however, the Commission did assume the power, upon investigation, to declare the rates established by the carriers to be unreasonable and to prescribe reasonable rates in lieu thereof to be followed in the future. The Commission exercised this power on the basis of express provisions of the Act, which, in the first place, declared that all rates must be just and reasonable, and that every unjust and unreasonable rate was prohibited and unlawful, and, in the second place, authorized and required the Commission to execute and enforce the provisions of the statute. On this basis the Commission proceeded for a period of ten years, without serious questioning even from the railroads, to prescribe maximum reasonable rates.

JUDICIAL NULLIFICATION OF THE COMMISSION'S AUTHORITY

In 1897, however, in the Cincinnati Freight Bureau Case, which has come to be known as the Maximum Freight Rate Decision, the Supreme Court of the United

[7] Thatcher v. Delaware and Hudson Canal Company, 1 I. C. C. Rep. 152.

[8] Cincinnati Freight Bureau v. C., N. O. & T P. Ry. Co., 7 I. C. C. Rep. 191.

States definitely decided that the Commission had no power to prescribe rates for the future, its authority to pass upon the reasonableness or the unreasonableness of rates being limited entirely to determining whether the rates fixed by the carriers in the past were reasonable or unreasonable. This decision effectively destroyed the rate-making power of the Interstate Commerce Commission. The reasoning on the basis of which the Supreme Court reached its conclusion may best be expressed in its own words. Mr. Justice Brewer thus summarized the position of the Court:

> We have therefore these considerations presented: First. The power to prescribe a tariff of rates for carriage by a common carrier is a legislative, and not an administrative or judicial function, and, having respect to the large amount of property invested in railroads, the various companies engaged therein, the thousands of miles of road, and the millions of tons of freight carried, the varying and diverse conditions attaching to such carriage, is a power of supreme delicacy and importance. Second. That Congress has transferred such a power to any administrative body is not to be presumed or implied from any doubtful and uncertain language. The words and phrases efficacious to make such a delegation of power are well understood, and have been frequently used, and, if Congress had intended to grant such a power to the Interstate Commerce Commission, it cannot be doubted that it would have used language open to no misconstruction, but clear and direct. Third. Incorporating into a statute the common-law obligation resting upon the carrier to make all its charges reasonable and just, and directing the Commission to execute and enforce the provisions of the act, does not by implication carry to the Commission, or invest it with the power to exercise, the legislative function of prescribing rates which shall control in the future. Fourth. Beyond the inference which irresistibly follows from the omission to grant in express terms to the Commission this power of fixing rates is

the clear language of section 6, recognizing the right of the carrier to establish rates, to increase or reduce them, and prescribing the conditions upon which such increase or reduction may be made, and requiring, as the only conditions of its action—first, publication; and, second, the filing of the tariff with the Commission. The grant to the Commission of the power to prescribe the form of the schedules, and to direct the place and manner of publication of joint rates, thus specifying the scope and limit of its functions in this respect, strengthens the conclusion that the power to prescribe rates or fix any tariff for the future is not among the powers granted to the Commission. These considerations convince us that under the Interstate Commerce Act the Commission has no power to prescribe the tariff of rates which shall control in the future, and therefore cannot invoke a judgment in mandamus from the courts to enforce any such tariff by it prescribed. . . . Our conclusion, then, is that Congress has not conferred upon the Commission the legislative power of prescribing rates, either maximum or minimum or absolute. As it did not give the express power to the Commission, it did not intend to secure the same result indirectly by empowering that tribunal to determine what in reference to the past was reasonable and just, whether as maximum, minimum, or absolute, and then enable it to obtain from the courts a peremptory order that in the future the railroad companies should follow the rates thus determined to have been in the past reasonable and just.[9]

THE RE-ESTABLISHMENT OF THE RATE-MAKING POWER

The nullification of the Commission's rate-making power resulting from this decision virtually undermined the whole system of administrative control which had been sought to be established through the Act to Regulate Commerce. With the Commission stripped of its power to prescribe rates for the future, there was no effective rem-

[9] Interstate Commerce Commission v. C, N. O. & T. P. Ry. Co., 167 U. S. 479.

edy against unreasonable rates for the shipper, and no adequate protection for the general public. In the words of Professor Dixon:

> The Supreme Court's decision that the Commission could not prescribe a rate for the future left to the shipper merely the privilege of suing for excessive charges when a rate had been held by the Commission to be unreasonable. This the individual shipper usually failed to do, the amount in controversy in any individual case being usually too small to warrant it. Moreover, the one who paid the freight rate was frequently a middleman, and the individual who actually suffered from the excessive rate, the consumer or the producer, had no standing in court and could not recover. The only adequate relief from such a situation was to clothe the Commission with power to prevent such occurrences in the future.[10]

This situation was an important factor in the enactment of the Hepburn amendments of 1906. As a result of the Hepburn Act, the Commission is now definitely clothed with power, not only to declare existing rates unjust or unreasonable, but to prescribe reasonable rates to be followed in the future. The initiative in rate-making still rests with the railways, but ample power for effective control is vested in the Commission.

In the course of the legislative discussion of the Hepburn Act, earnest doubt was expressed as to the constitutionality of such a delegation by Congress of legislative authority to an administrative commission as was involved in the rate section of the Act. In the Maximum Freight Rate Decision the Supreme Court had denied that the original Act to Regulate Commerce had conferred such authority upon the Commission; it did not deny that Congress possessed the right to delegate this

[10] Frank H. Dixon, "The Interstate Commerce Act as Amended in 1906," *Quarterly Journal of Economics*, 1906, 22-51.

rate-making power. On the contrary, the court made the assertion that:

> Congress might itself prescribe the rates, or it might commit to some subordinate tribunal this duty, or it might leave with the companies the right to fix rates, subject to regulation and restrictions, as well as to that rule which is as old as the existence of common carriers, to wit, that rates must be reasonable.

Moreover, it is a general rule of law that, although legislative power cannot be delegated, the law-making body may fix a standard to which rates shall conform and entrust to an administrative body the duty of adjusting rates in conformity with that standard. On the basis of this principle the constitutionality of the Hepburn Act has been judicially upheld, and the authority of the federal government to regulate railway rates through the Interstate Commerce Commission is now established beyond question.

The Doctrine of Judicial Review

Both the states and the national government, then, may regulate railway rates either through direct legislative enactment or through the instrumentality of administrative commissions. But in a series of very important decisions under the Fourteenth Amendment, the United States Supreme Court finally decided that neither legislatures nor commissions have the power to establish conclusive rates for common carriers. Final determination of the reasonableness or the unreasonableness of railway rates is vested in the courts and not in the legislatures. The establishment of the doctrine of judicial review may best be traced through the words and decisions of the courts.

ITS DENIAL

The problem first arose in the Granger cases. The railways not only denied the right of the legislatures to regulate railway rates, in which claim, as we have seen, they were squarely overruled by the Supreme Court, but they also protested that the rates prescribed were so low as to deprive them of an adequate return on the capital invested. They appealed to the courts for protection on the ground that, even if the legislatures possessed the right to fix rates, the courts should exercise their superior right to determine whether the rates so established were reasonable, in order that the railway companies might not be deprived of their property without due process of law. The first answer of the Court was in opposition to the railways and in support of the legislative authority to determine conclusively the rates to be charged by railway companies. In Munn v. Illinois Chief Justice Waite said for the Court:

> It is insisted, however, that the owner of property is entitled to a reasonable compensation for its use, even though it be clothed with a public interest, and that what is reasonable is a judicial and not a legislative question. As has already been shown, the practice has been otherwise. In countries where the common law prevails, it has been customary from time immemorial for the legislature to declare what shall be reasonable compensation under such circumstances, or, perhaps more properly speaking, to fix a maximum beyond which any charge made would be unreasonable. . . . The controlling fact is a power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied.[11]

This position as to the supremacy of the legislature in

[11] 94 U. S. 113.

rate-making was definitely confirmed in another of these early cases in the following words:

> Where property has been clothed with a public interest, the legislature may fix a limit to that which shall in law be reasonable for its use. This limit binds the courts as well as the people. If it has been improperly fixed, the legislature, not the courts, must be appealed to for the change.[12]

ITS EMERGENCE

These two cases, as well as a number of others belonging to this Granger group which involved the validity of railway rates fixed by the legislatures of middle western states, were decided in 1876. By 1885 doubt began to be cast upon the conclusive rate-making power of the states, and the seeds of the doctrine of judicial review began to appear. In the so-called Railroad Commission Cases already referred to, involving an effort by the railways to prevent the enforcement of rates under a Mississippi statute, the Court upheld the validity of the statute and affirmed the right of the state to fix rates, but limitations upon the rate-making power of the states were suggested. Chief Justice Waite declared:

> From what has been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretense of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law.[13]

12 Peik v. C. & N. W. Ry. Co., 94 U. S. 164.

13 Stone v. Farmers' Loan & Trust Co., 116 U. S. 307.

ITS ESTABLISHMENT

Finally, in the Minnesota Rate Cases,[14] the original position of the Court was entirely reversed. In Chicago, Milwaukee & St. Paul Railroad Co. v. Minnesota the doctrine was definitely established that the reasonableness of railway rates fixed by the states is subject to review by the courts. In this case, under a Minnesota statute authorizing a commission to prescribe railway rates, the Commission reduced the rates for the transportation of milk between certain points from three cents to two and a half cents per gallon, and the charges for switching cars from $1.25 and $1,50 to $1.00 per car. Under the statute the rates fixed by the Commission were declared to be conclusive. Appeal was brought to the federal courts on the ground that the denial of a judicial determination of the reasonableness of these rates was a confiscation of property without due process of law. The Supreme Court upheld the claim of the railroad, declaring invalid the Minnesota statute in which the rates established by the Commission were held to be conclusive. The Court said:

> The question of the reasonableness of a rate of charge for transportation by a railroad company, involving, as it does, the element of reasonableness, both as regards the company and as regards the public, is eminently a question for judicial investigation, requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law, and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are per-

[14] C., M. & St. P. Railway Co. v. Minnesota, 134 U. S. 418; M. E. Ry. Co. v. Minnesota, 134 U. S. 467.

mitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.

THE BASIS OF THE DOCTRINE

This decision, then, clearly established the right of judicial review. It apparently shifted the entire burden of rate regulation from the legislatures to the courts, substituting, in this vital matter of public policy, judicial for legislative opinion. In so far as this case appeared to assert the right of the court to enforce its judgment in rate-making in place of the judgment of legislatures or commissions, it has been modified by subsequent decisions. The doctrine of judicial review, as at present applied, merely involves a determination by the court whether the rates fixed by legislatures or commissions are so unreasonable as to amount to confiscation of property rather than to mere regulation of public callings. So interpreted, the doctrine does not involve a usurpation of legislative authority by the courts; it is but the enforcement of such limitations upon legislative authority as are guaranteed by the fundamental law of the land.

The conflict is not between the legislatures and the courts, but rather between the legislatures and the people. In this, as in all forms of judicial censorship of legislation, the courts are upholding the rights of the people by the enforcement of the constitutional guarantees which exist for the protection of the people. In specific cases the courts sometimes render decisions nullifying legislation which are clearly in opposition to the best public welfare; but the mere right to review legislative acts springs from the nature of our constitutional system and not from usurpation by the courts. The real basis of judicial censorship may be stated in the words of the Supreme Court of the United States:

The idea that any legislature, state or federal, can conclusively determine for the people and for the courts that what it enacts in the form of law, or what it authorizes its agents to do, is consistent with the fundamental law, is in opposition to the theory of our institutions. The duty rests upon all courts, federal and state, when their jurisdiction is properly invoked, to see that no right secured by the supreme law of the land is impaired or destroyed by legislation. This function and duty of the judiciary distinguishes the American system from all other systems of government. The perpetuity of our institutions and the liberty which is enjoyed under them depend, in no small degree, upon the power given the judiciary to declare null and void all legislation that is clearly repugnant to the supreme law of the land.[15]

The Basis of Rate Reasonableness

STANDARDS OF REASONABLENESS [16]

The right of the courts to review railway rates fixed by legislatures and commissions necessitated the development by the courts of standards of reasonableness. On what basis is the reasonableness of a railway rate to be tested? This is the great question in railway regulation which is now agitating the minds of courts, commissions, and students of railway economics.

[15] Smyth v. Ames, 169 U. S. 466.

[16] In the discussion which follows concerning the standards of reasonableness developed by courts and commissions in the regulation of railway rates, it should be noted that the construction of the rate schedule as a whole is usually under consideration. In the adjustment of individual rates, or small groups of rates, such questions as the investment value of the carrier's property are generally disregarded. The term "reasonable" as it is often used means that rates are reasonable when compared with other rates rather than that the rates in and of themselves are reasonable. For example, it is quite common in connection with cases before the Interstate Commerce Commission to refer to the reasonableness of a rate on some specified commodity moving between specified points. In such a case it will generally be found that the basis used is comparison with other rates on the same or similar traffic. In such cases it would not be possible to consider such questions as investment.

The first important answer, which still remains the starting-point of all court and commission decisions on rate reasonableness, was given in the famous case of Smyth v. Ames, decided in 1898. This case involved the validity of railway freight rates prescribed under a Nebraska statute of 1893. An injunction restraining the enforcement of these rates was obtained in the circuit court by the railways and was confirmed by the Supreme Court. Justice Harlan, in delivering the unanimous opinion of the Court, said:

We hold, however, that the basis of all calculation as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction. the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given

The prevailing practice and the grounds upon which this practice is based have been described as follows by H. C. Lust in *The Act to Regulate Commerce and Supplemental Acts:*

As a practical proposition, the proof concerning the unreasonableness of individual rates is often different from that pertaining to an entire system of rates The investment of the carrier, for instance, in carrying a specified kind of traffic, such as piano traffic, cannot be ascertained; so in such instances the most common method of proof is to compare the rate attacked with rates on similar commodities transported under similar conditions, either by the defendant carrier or by other railroads. Of course, on heavy commodities, such as coal, lumber, and the like, where such traffic constitutes from one-third to two-thirds of the entire freight traffic of the carrier, accountants often endeavor to ascertain the investment of the carriers in such traffic, and the actual cost of the service If such statistics are accurately ascertained, they are very important in the determination of what is a reasonable rate for such traffic.

such weight as may be just and right in such case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.[17]

PHYSICAL VALUATION

The important proposition laid down in Smyth v. Ames was that the basis of reasonable rates must be "the fair value of the property being used by it for the convenience of the public," or that "what the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience." It is true that many possible standards are mentioned, but no definite dictum is forthcoming from the Court as to the relative merits of these standards, or as to what constitutes the controlling considerations for a basis of rate reasonableness.

The insistence of the Court that railways are entitled to a fair return on a fair value of their property has shifted the emphasis in rate regulation to the valuation of railway property. Such valuations have been made by a number of the states, and a comprehensive appraisal of railway properties throughout the United States is now being made under the supervision of the Interstate Commerce Commission. Many different standards of valuation are possible. The entire technique of railway valuation is now in the process of development, and there is great divergence in the principles accepted by courts, commissions, and students.

[17] 169 U. S. 466.

MARKET VALUE

The valuation of railway property on the basis of earning capacity, though often urged by railway advocates, is clearly an improper method of determining the fair value upon which railways are entitled to a fair return. The market value of the property which such a valuation would produce must itself be dependent upon the earnings whose reasonableness is in question. To say that railway rates should be reasonable and at the same time to insist that their reasonableness must be tested by the return which they yield on a value dependent upon the income produced by these very rates is clearly to argue in a circle. Such valuation is commercial rather than physical. It would nullify all attempts at rate regulation by absorbing monopoly as well as legitimate profits. For rate-making purposes, in a public service enterprise, earning capacity cannot serve as an adequate or as a desirable basis of valuation. Whitten, in his standard work on the valuation of public service corporations, says:

> Market value has nothing to do with the rate question. . . . It is only set up after the rates are in fact determined. To be sure, the theory is that rates are based on a fair return on the market value of the road under reasonable rates. The impossibility of basing reasonable rates on a market value that is itself determined by reasonable rates is apparent. It is a clear case of reasoning in a circle. We have the evident absurdity of requiring the answer to the problem before we can undertake its solution. The advocates of the market-value theory cannot really mean what they say. Market value is not really a part of the process, but the final result. It includes in many cases a capitalization of certain monopoly profits and the monopoly value thus created is set up as justifying the higher rates which have, in fact, created the monopoly value.[18]

[18] R. H. Whitten, Valuation of Public Service Corporations, 1, § 57.

There are two other standards of valuation, each more reasonable than market value based upon earning capacity, which claim many staunch supporters and are largely applied in practice; namely, *actual cost* and *present value*.

ACTUAL COST

Actual cost, in its proper sense, includes the cost of original construction plus the cost of additions and betterments. It is not equivalent to book value, as has been assumed in a number of commission and judicial decisions, and should not properly include, therefore, such items as "discount on securities issued, exorbitant profits to promoters, cost of replacing worn-out or superseded property, dividends paid out of capital, money sunk in unsuccessful experiments." [19]

Actual cost presents the most natural standard of value for rate-making purposes. A railroad corporation is entitled to a reasonable return on its investment, and the actual cost involved in the creation of the property devoted to the public service is the most direct and the most obvious measure of the investment. In the Western Rate Advance Case of 1911 the Interstate Commerce Commission said:

> Perhaps the nearest approximation to a fair standard is that of bona fide investment—the sacrifice made by the owners of the property—considering as part of the investment any shortage of return that there may be in the early years of the enterprise.[20]

But while actual cost is coming to be recognized by many keen and able students of the problem as the most desirable standard of railway valuation, it has not received very extensive legal approval. The difficulties

[19] Whitten, 1, § 95.

[20] 20 I. C. C. Rep. 307.

involved in the determination of actual cost, because of the unsoundness and inaccuracy of early accounting practices and the lack or inadequacy of historical records, have been the chief obstacles to the acceptance of this standard of valuation. It has been urged, in addition, that such a basis of valuation would impose upon the public the burden of unwise or dishonest investments and deprive the railroads of a just return, appearing in the enhanced value of their properties, for unusual enterprise or exceptional efficiency.

PRESENT VALUE

The present value of railway property, then, is usually taken by courts and commissions as the legal measure of the investment upon which a fair return may be earned. Present value is determined by ascertaining the cost of reproducing the property new, with such deduction for depreciation as will make the value so obtained reflect the present condition of the plant.

This method of valuation, it is claimed, is free from the difficulties and objections which are alleged to stand in the way of the actual cost basis. It is urged that the public is entitled to service at such rates as will yield a fair return on an investment that would be necessary for the provision of this service at the present time, and that the railroads are entitled to a fair return on such an investment as would have to be made at the present time in order to provide this service.

Nevertheless, the present-value basis has been subjected, particularly in recent years, to very sharp attack. For example, Professor Bemis, an expert in railway valuation, has said:

> The "reproduction theory" contemplates an imaginary community in which an imaginary corporation makes imaginary

estimates of the cost of an imaginary railroad. . . . The actual, efficient sacrifice of the investor, as revealed in accounting and other historical studies, supplemented by engineering advice as to the adaptability and present condition of the properties for the purpose intended, will count far more than the estimates of engineers as to what it will cost to buy land that will never be bought again, to duplicate property that will never have to be duplicated, and to build up a business that will never again have to be developed.[21]

In spite of keen criticism and respectable opposition, present value, or cost of reproduction less depreciation, is the generally accepted legal standard of railway valuation.

PROBLEMS IN VALUATION

In the application of this cost-of-reproduction theory many difficult, and for the most part still unsettled, problems have arisen. There is, for example, the question as to how far intangible elements shall be included in determining the cost of reproduction of an existing plant. Shall any value be attributed to the existence of good-will, or to the fact that the enterprise is a going concern? Different answers are given to this question in different jurisdictions, and scarcely anywhere is the answer definite and final. There is the question, too, as to whether allowance shall be made for the appreciation of railway property, as well as deduction for its depreciation. The answer to this question is also varied and inconclusive.

One of the most important of these problems concerns the valuation of railway lands and rights of way. On the basis of cost of reproduction the railroads should clearly

[21] E. W. Bemis, in the Proceedings of the National Association of Railway Commissioners, 1913.

be allowed the present value of their lands, and not merely the expenditure involved in their acquisition. But how is present value to be determined? Is it equivalent to the value of adjoining lands, or must it be computed on the basis of what the railways would have to pay for such lands if they were to be acquired for railway purposes at the present time? To estimate the value of rights of way on the basis of the value of adjoining lands is to allow the railways the benefit of the so-called unearned increment, that is, of the appreciation in property values resulting from the general growth of the community. To estimate the value of rights of way on the basis of what would have to be paid for these lands at the present time for railway purposes is to sanction the use of so-called multipliers, because, it is claimed, land for railway purposes has a normal market value of two or three times the market value of the same land for other than railway purposes. The latest and most authoritative answer to this problem, as well as a profitable discussion of the cost-of-reproduction theory as a whole, was given in the famous Minnesota Rate Case of 1913.[22]

THE MINNESOTA RATE CASE

In this case suits were brought by stockholders of the Northern Pacific Railway Company, the Great Northern Railway Company, and the Minneapolis and St. Louis Railroad Company to restrain the enforcement of two orders of the Minnesota Railroad and Warehouse Commission and two acts of the Minnesota legislature, prescribing maximum freight and passenger rates, and to prevent the adoption or maintenance of these rates by the railroad companies.

[22] 230 U. S. 352.

The grounds of complaint were, first, that the action of the legislature and the commission amounted to an unconstitutional interference with interstate commerce, and second, that the rates established were confiscatory. The first of these problems, dealing with the respective rights of the states and the national government in railway regulation, will be treated in a later chapter. The second problem involved the legality of the valuation on the basis of which the reasonableness of the rates fixed by the legislature and the commission was to be determined. More particularly, the principles of land valuation received the careful consideration of the Court. The issue and the conclusion may best be stated, somewhat at length, in the words of Mr. Justice Hughes, who delivered the opinion of the Court:

> That question is whether, in determining the fair present value of the property of the railroad company as a basis of its charges to the public, it is entitled to a valuation of its right of way not only in excess of the amount invested in it, but also in excess of the market value of contiguous and similarly situated property. For the purpose of making rates, is its land devoted to the public use to be treated (irrespective of improvements) not only as increasing in value by reason of the activities and general prosperity of the community, but as constantly outstripping in this increase all neighboring lands of like character, devoted to other uses? If rates laid by competent authority, state or national, are otherwise just and reasonable, are they to be held to be unconstitutional and void, because they do not permit a return upon an increment so calculated?
>
> It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just

return for the use of the property involves the recognition of its fair value, if it be more than the cost. The property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law. But still it is property employed in a public calling, subject to governmental regulation, and while, under the guise of such regulation, it may not be confiscated, it is equally true that there is attached to its use the condition that charges to the public shall not be unreasonable. And where the inquiry is as to the fair value of the property, in order to determine the reasonableness of the return allowed by the rate-making power, it is not admissible to attribute to the property owned by the carriers a speculative increment of value, over the amount invested in it and beyond the value of similar property owned by others, solely by reason of the fact that it is used in the public service. That would be to disregard the essential conditions of the public use, and to make the public use destructive of the public right.

The increase sought for "railway value" in these cases is an increment over all outlays of the carrier and over the values of similar land in the vicinity. It is an increment which cannot be referred to any known criterion, but must rest on a mere expression of judgment which finds no proper test or standard in the transactions of the business world. It is an increment which, in the last analysis, must rest on an estimate of the value of the railroad use as compared with other business uses; it involves an appreciation of the returns from rates (when rates themselves are in dispute) and a sweeping generalization embracing substantially all the activities of the community. For an allowance of this character there is no warrant.

Assuming that the company is entitled to a reasonable share in the general prosperity of the communities which it serves, and thus to attribute to its property an increase in value, still the increase so allowed, apart from any improvements it may make, cannot properly extend beyond the fair average of the normal market value of land in the vicinity having a similar character.

Otherwise we enter the realm of mere conjecture. We therefore hold that it was error to base estimates of value of the right of way, yards, and terminals upon the so-called "railway use" of the property. The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average market value of similar land in the vicinity, without additions by the use of multipliers, or otherwise, to cover hypothetical outlays. The allowances made below for conjectural cost of acquisition and consequential damages must be disapproved, and, in this view, we also think it was error to add to the amount taken as the present value of the lands the further sums, calculated on that value, which were embraced in the items of "engineering, superintendence, legal expenses," "contingencies," and "interest during construction."

The principles of railway valuation are thus being authoritatively developed by courts and commissions, and satisfactory solutions are gradually being reached for the more difficult outstanding problems. Of all the questions in the field of railway regulation, the theories and methods of valuation are now receiving the widest and most thorough-going attention. The comprehensive physical valuation of the American railway net, which is being conducted at the present time by the Interstate Commerce Commission with the willing co-operation of the railways, will doubtless result in a substantial contribution to the proper treatment of the many railway valuation problems. Through the excellent process of careful investigation, enlightened discussion, and judicial decision a sound legal and economic basis of rate reasonableness will be gradually established.

TEST QUESTIONS

1. On what grounds did the United States Supreme Court uphold the regulation of railways by the states?
2. State briefly the limitation of the Interstate Commerce Commission's authority by the courts.
3. What standard of rate reasonableness was set forth in Justice Harlan's decision in Smyth v. Ames?
4. What effect did this decision have in emphasizing the importance of physical valuation of railways?
5. Why cannot earning capacity be taken as a basis for valuation for rate-making purposes?
6. Discuss briefly actual cost and present value in the determination of reasonable rates.
7. Give the substance of the Supreme Court decision in the Minnesota Rate Case of 1913.

CHAPTER VII

RAILWAY DISCRIMINATION

The Causes of Railway Discrimination

We have seen in an earlier chapter that railway discrimination, like general rate-cutting, springs primarily from the very nature of the railway business. Now and then special or exceptional causes appear. Railway managers occasionally allow preferential rates as a means of stimulating traffic at a particular juncture in order to be able to issue favorable reports for their roads and thereby enhance the market value of their securities. It also happens not infrequently that railway companies are financially interested in manufacturing plants or in mining enterprises along their rights of way, and hence find it a matter of especial advantage to quote unduly favorable rates to such concerns as against their competitors. In like manner, the existence of interlocking directorates, whereby railway officers serve at the same time as directors of industrial enterprises, often results in concessions to special interests.

Primarily, however, discriminatory practices are resorted to because of the compelling desire to increase railway traffic as a means of enlarging railway profits. Every increase in business results in much more than a proportionate increase in net returns. There is a powerful stimulus to add to a railway's traffic, and the rivalry for business becomes irresistibly keen. In the absence of public control, therefore, railway managers, imbued primarily

with the spirit of private gain, are determined to obtain business at any cost. Discrimination in rates and service is bound to follow. Here, as elsewhere in our analysis, it becomes clear that the economic characteristics of the railway business—the fact that railway expenditures are largely joint and constant, that railway undertakings are subject to increasing returns, that the passion for railway traffic is keen and uncontrollable, that railway competition normally leads to its own destruction—are the underlying sources of the evil. In other words, unregulated railway enterprise inevitably results in discriminatory practices. The railways have voluntarily built up industrial monopolies through special favors as a means of furthering their own ends, and have subsequently been compelled to continue their discriminations because of the pressure which these powerful monopolies have brought to bear upon them. And even in the first instance, industrial concerns have often secured special treatment from the railways by recognizing the railways' peculiar dependence upon large traffic and by playing one road off against another.

These underlying causes of discrimination have often been recognized and stated by railway officials as well as by public authorities. A classical exposition of the circumstances which lead to discrimination may be found in the testimony of a railroad man (Mr. C. M. Wicker of Chicago) before the Cullom Committee of the United States Senate in the investigation of 1886. He said:

> Here is quite a grain point in Iowa, where there are five or six elevators. As a railroad man I would try and hold all these dealers on a level keel, and give them all the same traffic rate. But suppose there was a road five or six miles across the country and all these dealers should begin to drop in on me every day or two and tell me that the road across the country was reaching within a mile or two of our station and drawing to itself all the

CHAPTER VI

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grain. You might say that it would be the right and just thing to do to give all the five or six dealers at the station a special rate to meet that competition through the country. But, as a railroad man, I can accomplish the purpose better by picking out one good, smart, live man, and, giving him a concession of three or four cents a hundred, let him go there and scoop the business. I would get the tonnage, and that is what I want. But if I give it to the five it is known in a very short time.

The Interstate Commerce Commission, in its twelfth annual report, gives like recognition to these factors and describes the causes of railway discrimination as follows:

Generally speaking, he (the railroad manager) feels that he must have the traffic. His road is there and it can be used for nothing else. The property with which he stands charged may be seriously injured without that particular traffic, and he must get it when it is moving. He cannot lie idle for better prices or more prosperous conditions. There is therefore a constant temptation to obtain it at any cost. Now, the rates between two competitive points have been published. The manager of one road finds that business has abandoned his line, and he believes that it is moving by a rival route. He can draw but one inference, and that is, that his competitor has secretly reduced the rate. Under these circumstances, what shall he do? Shall he maintain the published rate and thereby abandon business? But that means disaster to his road, the loss of his reputation as a manager, and ultimately of his employment. What most managers actually do is to get the business by making whatever rate is necessary.[1]

The Nature of Discriminatory Practices

Their General Characteristics

Railway discriminations assume innumerable forms and appear in almost every conceivable disguise. They

[1] *Twelfth Annual Report of Interstate Commerce Commission*, 12.

may be characterized in a great variety of ways. They are usually classified as discriminations between commodities or different kinds of traffic, between localities or different sections of the country, and between persons or different shippers. Before the enactment of restrictive legislation, particularly in the years prior to the passage of the Act to Regulate Commerce, railway discriminations, whether between persons, commodities, or localities, were resorted to openly. The growth of hostile legislation has driven most of these practices under cover. This is true, however, only of personal discrimination. Discrimination between commodities and between localities may still be practiced openly; it results from every maladjustment of the freight classification and from every undue disregard of distance in the freight tariff. The published rates, therefore, lawfully adhered to, not infrequently operate to the undue preference or advantage of some and to the undue prejudice or disadvantage of others. Even today, then, railway discriminations are both open and secret.

Moreover, the special privileges sought to be granted through discriminatory practices are made available for the favored shipper, commodity, or locality through direct, easily discovered practices, or through indirect methods, difficult of discovery. This appears, obviously, from the fact that discriminations are granted through differences in the service rendered for the same charge, or through external advantages, as well as through preferential rates. That indirect preferences, exceedingly difficult to uncover and prove, are now chiefly resorted to by railways and shippers, becomes most clear however from an examination of the methods followed in effecting personal discrimination. The early and very crude form of carrying goods for favored shippers free or at reduced rates has for the most part been entirely relinquished.

And the little less crude form of charging the full rate nominally and effecting the discrimination through the repayment of part of the rate has likewise been abandoned to a very large extent. The expedients resorted to for granting rebates are more subtle and refined. Because of their comparative immunity from discovery and consequent governmental attack they have properly been denominated "smokeless rebates." We shall note concrete examples of these modern practices in our subsequent consideration of the forms of railway discrimination.

JUST AND UNJUST DISCRIMINATION

It is important to recognize that not all discriminatory practices are economically undesirable or legally prohibited. Certain forms of discrimination are almost universally accepted as fair and proper, being justified by considerations of social, economic, or political policy. The distinction between different classes of traffic as a result of which more rapid transportation is provided for perishable goods than for ordinary commodities is always approved. So, too, the discrimination between localities which is evidenced by special homeseekers' or colonists' rates is seldom regarded as open to objection. Other forms of discrimination, many of them as between persons, are specifically authorized in the statutes of the states and of the nation. The Act to Regulate Commerce, for example, permits the transportation of property free or at reduced rates for the national, state, or municipal governments, or for charitable purposes, or to and from fairs and expositions for exhibit thereat; it allows the issue of mileage books under certain conditions; it permits the interchange of passes for the officers, agents, and employees of common carriers and their families;

it authorizes free transportation in case of general epidemic, pestilence, or other calamitous visitation; and it provides that free transportation may be given to certain specifically enumerated classes of persons.[2]

Furthermore, the principle of discrimination is recognized both in the classification of freight and in the making of rates. The very idea of classifying commodities or departing from distance in the freight tariff involves discrimination between commodities and between localities. Whether such discrimination is desirable and proper depends largely upon its reasonableness in each particular case. Most classifications are clearly reasonable and necessary; it is undesirable, as we have already seen, from the standpoint both of the railways and of the public, to charge equal rates on all classes of commodities. In like manner, the existence of competition, between markets as well as between routes, necessitates a departure from a strict adherence to the distance principle in rate-making. It is unjust or undue or unreasonable discrimination between localities that is economically and legally indefensible.

This distinction between just and unjust railway discrimination is uniformly recognized in American legislation, both state and national. The Act to Regulate Commerce, for example, prohibits as unjust discrimination preferential treatment for a "like or contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions."[3] Discrimination as such is not prohibited; the law takes cognizance of due justification for preferential treatment. And again, the Act expressly declares it to be unlawful for a common carrier "to make or give

[2] Act to Regulate Commerce, as amended, sec. 22.

[3] *Ibid.*, sec. 2.

any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic," or to subject the same "to any undue or unreasonable prejudice or disadvantage."[4] The emphasis is clearly upon *undue or unreasonable* preference or advantage and upon *undue or unreasonable* prejudice or disadvantage. Under these provisions the so-called differentials—when, for example, lower rates are established from western points to Baltimore than to New York, for the purpose of allowing Baltimore some share of the import and export trade of the country—have been properly upheld; and in like manner, the railway practice of granting lower rates on imported goods or on goods intended for export than on purely domestic shipments may be deemed lawful. Large questions of policy inevitably arise in this differentiation between just and unjust discrimination, and sharp conflicts have resulted from the interpretation by judicial tribunals of these legislative provisions as applied by administrative commissions; but that such differentiation is both necessary and proper appears to be established beyond question. The problem of preventing unjust discrimination, then, particularly as between different commodities or categories of traffic and as between different localities or sections of the country, presents one of the most complex and most difficult tasks in railway regulation.

The Forms of Railway Discrimination

Their Interdependence

Railway discriminations, we have seen, are usually classified as discriminations between commodities, be-

[4] *Ibid.*, sec. 3.

tween localities, and between persons. In the end all discriminations are personal: they operate to the advantage or prejudice of particular shippers or consignees. In the case of discriminations between commodities or between localities, however, the basis of the preference consists in the shipper's offering a particular class of goods for transportation or in the fact that the shipment originates in or is destined for a particular place. All shippers of the given class of commodities and all persons offering goods to or from the given place are afforded equal treatment. In the case of personal discrimination, on the other hand, the identity of the particular shipper is the basis of the preference. A favored shipper, then, may receive his undue preference or advantage because he is shipping goods of a special class; because he is shipping goods to or from a special place; or because he, rather than one of his competitors, happens to be the consignor of the shipment.

DISCRIMINATION BETWEEN COMMODITIES

Discrimination between commodities manifests itself primarily in the classification of freight.[5] Special service regulations are also made, applicable only to particular classes of traffic. Whether a given classification or regulation is just and proper depends upon the reasonableness of the adjustment in that particular case. The principles upon which such proper adjustment must be based have been discussed in some detail in an earlier chapter.[6] Value of service, measured roughly by the

5 "All classification is discrimination. It is the segregation of things, which, from the special viewpoint of the classifier, are different, and the grouping of things, which, from his viewpoint, are similar."—S. O. Dunn, *The American Transportation Question*, 47.

6 This subject is treated in exhaustive detail in the more technical

relative values of different commodities, is the controlling factor in classification, though cost of service is given serious consideration by both railways and commissions. A few illustrations, in this place, will make more concrete the nature of these discriminations.

The Interstate Commerce Commission has been called upon to adjust relative rates between competitive and non-competitive commodities. In the case of competitive commodities, there is the problem of classifying articles offered for transportation in different stages of manufacture, their relative rates being an important factor in determining the place where the later stages of manufacture shall be carried on, and the allied problem of classifying articles which may be used as possible substitutes for each other, their relative rates being an important factor in determining which one shall prevail.

With regard to competitive commodities in different stages of manufacture, the Commission ordered that the rate on unfinished bed-room sets should be 85 per cent of the rate on the finished articles.[7] On the same principle, the Commission condemned the practice of classifying hatters' furs and fur scraps as double first class, while fur hats, the finished product, were designated as first class.[8] In like manner, the Commission allowed a differential of 3 cents per 100 pounds on the transportation of corn meal as compared with corn from the Missouri river to points in Texas,[9] and a differential of

volumes on classifications and rates which constitute the chief part of the course in Interstate Commerce and Railway Traffic.

[7] Potter Mfg. Co. v. C. & G. T. Ry. Co. et al., 5 I. C. C. Rep. 514; 4 I. C. R. 223.

[8] Myer v. C. C. C. & St. L. Ry. Co. et al., 9 I. C. C. Rep. 78.

[9] 11 I. C. C. Rep. 220.

5 cents on the transportation of these commodities from the Missouri river to the Pacific coast.[10]

The best example of the adjustment of rates between competitive commodities which may be used as possible substitutes for each other is to be found in the decision of the Commission as to the relative rates which should prevail on Pearline and common soap.[11] The question was as to the rates on these two commodities between New York and Atlanta. Pearline appeared in class four of the Southern Classification, with a rate of 73 cents per 100 pounds; common soap appeared in class six, which would normally have given it a rate of 49 cents, but received a special rate of 33 cents per 100 pounds because of the existence of water competition between New York and Atlanta. It was shown that Pearline could be used as a substitute for common soap and was in direct competition with it; that Pearline was about twice as valuable as the soap and the risk of carrying it a little greater; and that the water competition at Savannah, which reduced the rate on soap to Atlanta, was not applicable to Pearline because it could not move by water on account of its susceptibility to dampness. The Commission decided that there was undue discrimination against Pearline and ordered that it be placed in class five, with a rate of 60 cents per 100 pounds. This rate was still almost twice the rate on common soap. The Commission based its decision largely on the value-of-service principle.[12]

[10] 11 I. C. C. Rep. 212.

[11] James Pyle & Sons v. E. T. V. & G. R R. Co., 1 I. C. C. Rep. 465.

[12] "The decision seems to rest chiefly on the difference in the value of the two commodities, though it should be noticed that two other considerations furnish a partial explanation, viz. the risks (i. e. the cost) of transportation and, in the case of the special Atlanta rate, the existence of water

In the case of non-competitive commodities, too, relative values have served as the primary criterion for distinguishing between just and unjust discrimination. Thus, for example, the Commission held it unjust and unreasonable to put raisins in a higher class than dried fruits, on the ground that the market value of raisins was uniformly lower than that of dried fruits;[13] and, in like manner, it ordered celery to be given the same classification and rates as were given to such vegetables as cauliflower, asparagus, and lettuce, on the ground that its production had greatly increased and its market value had fallen since the original classification was put into effect, and that "it certainly is no more a table luxury than some of the vegetables which have a lower class."[14]

The effective prevention of discrimination between commodities, then, depends upon the existence of a comprehensive system of regulation, with adequate rate-making powers in the regulating body.

LOCAL DISCRIMINATION

Any departure from the distance principle in rate-making, due allowance being made for the constant character of terminal expenses, involves discrimination; any unreasonable departure from the distance principle constitutes unjust or unlawful local discrimination. The principles which determine the reasonableness of relative rates have been discussed in detail in an earlier chapter devoted to a consideration of the theories of

competition."—M. B. Hammond, *Railway Rate Theories of the Interstate Commerce Commission*, 29.

13 Martin v. S. P. Co. et al., 2 I. C. C. Rep. 1; 2 I. C. R. 1.

14 Tecumseh Celery Co. v. C. J. & M. Ry. Co., et al., 5 I. C. C. Rep. 663; 4 I. C. R. 318.

rate-making and rate-making practice. It appeared that the existence of competition was the primary factor in bringing about a disregard of distance by American railways.

The relation of rates to each other is of much greater importance both to the shipper and to the general public than the absolute level of rates. The location of industries and the prosperity of communities are directly dependent upon the adjustment of railway rates as between different commercial centers and sections of the country. Most disputes, therefore, which come before our state and national commissions involve the question of local discrimination. A just settlement of these disputes necessitates a proper appreciation of the significance and the complexities of railway and commercial competition, of competition of routes and competition of markets. This task presents one of the most difficult problems in the whole range of railway economics and goes to the very root of railway regulation. To a larger extent even than in the case of discrimination between commodities or different classes of traffic, the effective elimination of local discrimination can be hoped for only through a comprehensive system of regulation, with large rate-making powers vested in a regulating body composed of expert and far-sighted men.

THE BASIS AND EXTENT OF LOCAL DISCRIMINATION

The nature of this task will appear more clearly from a consideration of the motives which lead to local discrimination and of the extent to which it prevails. These motives may best be presented through a concrete illustration; and the classical illustration of the philosophy

of local discrimination is to be found in President Hadley's standard discussion.[15]

On the coast of Delaware, a few years ago, there was a place which we shall call X, well suited for oyster-growing, but which sent very few oysters to market, because the railroad rates were so high as to leave no margin of profit. The local oyster-growers represented to the railroad that if the rates were brought down to one dollar per hundred pounds, the business would become profitable and the railroad could be sure of regular shipments at that price. The railroad men looked into the matter. They found that the price of oysters in the Philadelphia market was such that the local oystermen could pay one dollar per hundred pounds to the railroad and still have a fair profit left. If the road tried to charge more, it would so cut down the profit as to leave men no inducement to enter the business. That is, those oysters would bear a rate of one dollar per hundred, and no more. Further, the railroad men found that if they could get every day a carload, or nearly a carload, at this rate, it would more than cover the expense of hauling an extra car by quick train back and forth every day, with the incidental expenses of interest and repairs. So they put the car on, and were disappointed to find that the local oyster-growers could only furnish oysters enough to fill the car about half full. The expense to the road of running it half full was almost as great as running it full; the income was reduced one half. They could not make up by raising the rates, for these were as high as the traffic would bear. They could not increase their business much by lowering rates. The difficulty was not with the price charged, but with the capacity of the local business. It seemed as if this special service must be abandoned.

One possibility suggested itself. At some distance beyond X, the terminus of this railroad, was another oyster-growing place, Y, which sent its oysters to market by another route. The supply at Y was very much greater than at X. The people at Y were

[15] A. T. Hadley, *Railroad Transportation*, 116-117.

paying a dollar a hundred to send their oysters to market. It would hardly cost twenty-five cents to send them from Y to X. If, then, the railroad from X to Philadelphia charged but seventy-five cents a hundred on oysters which came from Y, it could easily fill its car full. This was what they did. They then had half a carload of oysters grown at X, on which they charged a dollar, and half a carload from Y, on which they charged seventy-five cents for exactly the same service.

Of course there was a grand outcry at X. Their trade was discriminated against in the worst possible way—so they said—and they complained to the railroad. But the railroad men fell back on the logic of facts. The points were as follows: 1. A whole carload at seventy-five cents would not pay expenses of handling and moving. 2. At higher rates than seventy-five cents they could not get a whole carload, but only half a carload; and half a carload at a dollar rate (the highest charge the article would bear) would not pay expenses. Therefore, 3. On *any* uniform rate for everybody the road must lose money, and, 4. They would either be compelled to take the oyster car away altogether, or else get what they could at a dollar, and fill up at seventy-five cents. There was no escape from this reasoning; and the oystermen of X chose to pay the higher rate rather than lose the service altogether.

President Hadley's discussion indicates the nature of the justification which may be offered for local discrimination. In essence it consists of the fact that it may be advantageous, rather than prejudicial, for the locality apparently discriminated against to have a lower rate allowed to the more distant point because of the existence at that point of railway or market competition. The contribution to fixed charges or constant expenditures which may be derived from the seemingly favored traffic diminishes rather than increases the burden to be borne by the local non-competitive traffic.

There is, however, a real danger to be guarded against.

Distance should be disregarded in the adjustment of rates only if the given traffic cannot be secured without the disregard of distance. Moreover, only such traffic as is reasonably tributary to a given road should be striven for through the instrumentality of rate adjustment. Otherwise serious economic waste would be the natural result, the gains of a particular railway being obtained at the expense of the community's welfare. The sole limitation upon roundabout or circuitous routing would be the extra or out-of-pocket cost of rendering the specific service. Furthermore, the discrimination, even when legitimate, must be reasonable. The rate at the more distant point must not be excessively low; the rate at the nearer point must not be excessively high. These problems can be solved successfully only by means of effective regulating machinery, so employed as to render full justice to the railways as well as afford adequate protection to the public.

In the trunk-line rate system, which controls the large traffic between the Atlantic seaboard and the middle west, a distance tariff largely prevails and there is a conspicuous freedom from local discrimination. In the southern basing-point system and in the transcontinental rate structure, the distance principle is generally disregarded and local discrimination is the most frequent and the most fundamental grievance in rate disputes. Even here, however, it is to be noted that the rate adjustments are the result of long historical development and, in large measure, of natural geographical conditions. Changes must be introduced slowly and cautiously. Only through the combined wisdom, honesty, and restraint of the railways and our public servants, state and national, can permanent improvement in the situation be assured without consequent impairment of well-established in-

dustrial conditions. The success with which rates are adjusted with reference to each other in the future will constitute the supreme test of our American system of railway regulation.[16]

PERSONAL DISCRIMINATION

In the case of personal discrimination, few if any of the economic justifications may be urged which underlie local discrimination and discrimination between commodities. The complexities of railway-rate adjustments present genuine and sometimes insurmountable difficulties in distinguishing between reasonable and unreasonable preferences for particular places or categories of traffic. But practically all discriminations between persons are unjust. They are especially objectionable because they have been used to build up unlawful monopolies in the industrial field and because they run counter to the American spirit of fair play. Moreover, in the present state of our law, they are granted and secured through secret means; and the expedients resorted to, in their modern forms, are so subtle and indirect as to make detection difficult and expensive, if not impossible.

Discrimination between persons may appear both in the passenger and in the freight service of the railways. In the passenger traffic relatively little difficulty has arisen, especially in recent years. Formerly the liberal dispensation of free passes to legislators, judges, and other public officers was an evil of great magnitude and importance, but drastic legislation by the states and the federal government has apparently proved entirely

16 Limitation of space precludes an analysis here of specific cases involving local discrimination. An excellent discussion of the problem, with a wealth of concrete detail, will be found in Ripley, *Railroads: Rates and Regulation*, chap. VII.

effective in abolishing this method of corruption.[17] The free-pass evil is now looked upon as a thing of the past, and rebates in passenger rates, though occasionally paid contrary to law, are exceedingly rare.

In connection with the freight traffic numerous forms of personal discrimination are to be found. The original practice, as already indicated, was to carry goods for the favored shipper free or at reduced rates; but this crude method has long ago been replaced by the practice of nominally charging the shipper the regular or published rate and effecting the discrimination through one expedient or another.

False billing, for example, was, and still is to no small extent, a favorite device. The shipper is charged the full rate for the shipment as described in the bill of lading; but this description may be intentionally false. A short weight may be stated; or a smaller number of packages may be named than are actually contained in the consignment; or the goods may be wrongly classified—often referred to as under-classification—so as to receive the benefit of a lower rate; or they may be billed as for export, when in fact they are intended for domestic consumption; or they may be billed as imported goods, when in fact they have been produced in this country; or they may be consigned as a through shipment, when in fact they are destined for a local non-competitive point. Somewhat allied to the practice of false billing (which is often resorted to without the knowledge or consent of the railway), is the device employed by traffic managers of charging some shippers according to the net, and others according to the gross, weight of their

[17] In a majority of these cases the carriers welcomed the legislation because it relieved them of the expense involved in carrying free a great number of persons.

shipments, and the expedient of quoting different rates for the same commodity packed in slightly different ways. Thus, for example, the Standard Oil Company, shipping in tank cars, was charged at one time only for the oil, while its competitors, shipping in barrels, were charged for transportation of both the oil and the barrels. This discrimination appeared all the more unjust because the Standard Oil Company's competitors were compelled to ship their oil in barrels, since there was an agreement between the Standard Oil Company and certain railways whereby the railways refused to supply tank cars to these competitors.

By far the most common expedient for effectually granting preferential rates to favored shippers is the much-condemned practice of rebating. A rebate in its original form consisted in the repayment to the shipper of part of the rate paid by him. Here, however, as in other cases, the general tendency has been to conceal the process as much as possible. Few railway rebates are now granted in this bare form; they are usually so disguised as to prevent easy detection. A few illustrations may be given of this modern form of rebating.

The payment of rentals for the use of private cars offers one class of opportunities for rebating. A shipper who uses his own car is charged the full rate for the transportation of his freight and is allowed a daily rental for his car as long as it is being used by the railway. If the rental chances to be a high one—beyond the actual value of the use of the car—a rebate is in effect given to the shipper. This form of abuse has been amazingly common, such large rentals being paid that in some cases they have amounted in the short period of two years to a sum sufficient to pay the original cost of the car, interest on the investment, and the expense of maintenance.

Rebating is accomplished also through the expedient of the industrial line. If it is desired to give concessions to a shipper whose plant is located slightly off the line of the railway yet connected with it by a short spur or side-track, the shipper organizes a special corporation as a railway company to own and operate the spur. Thenceforth a shipment from the factory or plant nominally passes over the lines of two companies—the newly organized line and the regular railway. Accordingly, when the charge for transportation is collected, it becomes necessary for the two companies to divide it between them, and the method of apportionment is usually such as to give the industrial line much more than its due share of the whole. The full rate, then, appears to be collected, but a rebate is allowed under the guise of a payment to the industrial line. Similar in character to this form of discrimination through the instrumentality of industrial lines is the device whereby a railway sometimes permits a favored shipper to perform some service, such as loading, in connection with the carriage of his goods, and thereupon allows as compensation for his labor a sum entirely out of proportion to the value of his service.

Even more pernicious than these forms of discrimination and less easy to discover are the rebates effected through the machinery of the claim department. A shipper is charged the published rate; but as soon as the carriage of his freight is completed, he files a false claim for fictitious injury to or loss of his goods, or an excessive claim for actual injury or loss. In accordance with a tacit agreement between the railway and the shipper, these claims are promptly paid. This practice clearly results in offensive rebating, though the payments

appear on the books of the railway company as legitimate items of expense.

The practices described in the preceding paragraphs, resulting for the most part in preferential rates, are perhaps the most serious forms of personal discrimination, but there are many preferences in the service rendered to different shippers, which likewise merit unquestioned condemnation.

A source of perennial complaint is found in the conduct of railways in the distribution of their cars. It is their acknowledged duty to supply all shippers with as many cars as they require, so far as their facilities will allow. If the supply of cars is inadequate, it is the duty of the railways to distribute them fairly among the several shippers in reasonable proportion to their respective needs. In practice, however, it is found that the railways not infrequently discriminate extensively in the distribution of cars. The big shipper can often secure all the cars he needs when the little shipper clamors for them in vain. In the matter of speedy transportation and prompt delivery similar distinctions are often made.

Certain special privileges are also granted to the favored shipper which are ordinarily denied by the railways. The right of milling in transit is an excellent example of such special privileges. If wheat is to be shipped from one point to a second, there to be converted into flour, and subsequently to be sent on to a third point, some shippers and millers are required to pay the local rate on wheat between the first two points and the local rate on flour between the second and third, while for the specially favored persons the two shipments are treated substantially as one, with the privilege of milling in transit, at a rate but slightly higher than the through rate on wheat. These favored individuals are thereby

given a decided advantage over those to whom the privilege is denied. A similar privilege is occasionally enjoyed by a shipper who consigns a car of freight at the carload rate, but is allowed to unload part of the goods at various points, while his competitors, if they desire to be granted the same privilege, are compelled to pay the less-than-carload rate on each separate consignment in the car.

The great variety of discriminatory practices and the subtlety and refinement of their forms are equally impressive. It is doubtless true, however, that the extent of these discriminatory practices has very markedly declined in recent years. In part this result has come through the voluntary recognition by the railways of the injurious effects of discrimination, to themselves as well as to the public; but in the main the notable decrease in the amount of discrimination has been secured through the enactment and enforcement of stringent legislation. It is necessary, here, to examine briefly the character and development of this legislation.

The Law Against Discrimination

General Prohibitions

From the beginnings of regulation, discriminatory practices have been declared unlawful in both state and federal legislation. The chief grievance at the time of the Granger movement was the extortionate character of railway rates, but the prohibition of discrimination was an essential part of the state legislation to which the movement led. And since the most important immediate factor in the enactment of the Act to Regulate Commerce in 1887 was the wide prevalence of discriminatory practices, the prohibitions against discrimination were the cardinal features of the statute as originally passed.

In the Act to Regulate Commerce an attempt is made to prevent discrimination in any form. It is provided that if any common carrier shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service rendered, or to be rendered, in the transportation of passengers or property, than it charges, demands, collects, or receives from any other person or persons for doing for him or them a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is prohibited and declared to be unlawful.[18] Furthermore, discrimination between goods and between places as well as personal discrimination is prohibited in general terms. It is declared to be unlawful for any common carrier to make or give any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic, in any respect whatsoever, or to subject any particular person, company, firm, corporation, or locality, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.[19]

One of the important purposes for which the Interstate Commerce Commission was created was to provide administrative machinery for the enforcement of these provisions. Heavy fines, as well as imprisonment,[20] are

18 Act to Regulate Commerce, as amended, sec. 2.

19 *Ibid.*, sec. 3.

20 The penalty of imprisonment was established in 1889; it was removed by the Elkins Act of 1903; and it was re-established by the Hepburn Act of 1906.

imposed for violations of these prohibitions against discriminatory practices. Shippers accepting rebates as well as railways granting them are guilty of unlawful conduct; and both the railway corporation and its officers and agents are subject to the penalties for violation of the provisions against discrimination.[21] Moreover, the provisions of the Act enjoining upon the carriers due publicity in rate-making and granting to the Commission general powers of investigation and supervisory authority over accounting practices were enacted and are utilized by the Interstate Commerce Commission, to a very large extent, as a means of enforcing more effectively the provisions against discrimination.

THE LONG-AND-SHORT-HAUL CLAUSE

One special form of local discrimination is specifically prohibited in most state laws and constitutes an important feature of the Act to Regulate Commerce. The famous fourth section of the Act, as enacted in 1887, declared it to be unlawful for the railways "to charge or receive any greater compensation in the aggregate for the transportation of passengers or of like kind of property, under substantially similar circumstances and conditions, for a shorter than for a longer distance over the same line, in the same direction, the shorter being included within the longer distance." From the very beginning[22] the Commission interpreted this clause as justifying a departure from the long-and-short-haul principle only when water competition or competition between railways not subject to the Act existed at the

21 Elkins Act, sec. 1.

22 Louisville and Nashville Case, 1 I. C. C. Rep. 31.

more distant point.[23] In other words, the mere existence of railway competition at the more distant point did not, in the opinion of the Commission, constitute such dissimilarity of circumstances and conditions as to remove a given case from the prohibition of the fourth section. This interpretation was uniformly applied for a period of ten years, but it was concurred in by the railways only under vigorous protest.

ITS NULLIFICATION

In 1897 the Supreme Court of the United States, by its decision in the Alabama Midland Case,[24] overruled the Commission's interpretation of the fourth section and effectually nullified the application of the long-and-short-haul principle in the adjustment of railway rates.

The case was first decided by the Interstate Commerce Commission in 1893. The facts, briefly, were as follows: Troy, Alabama, is situated 52 miles east of Montgomery, on the Alabama Midland Railroad. The rates on the Alabama Midland Railroad from all points in the east and northeast were higher to Troy than to Montgomery, although traffic passed through Troy on its way to Montgomery, and the rates from Troy to eastern points were higher than the rates from Montgomery, although traffic from Montgomery passed through Troy on its way to the eastern seaports. The carrier justified the lower rates at Montgomery because of the existence at that point of several lines of railway competing for all kinds of traffic. Railway competition at Montgomery, largely absent at Troy, constituted such a dissimilarity of circumstances

23 Certain "rare and peculiar" cases were also excepted by the Commission. Compare the *First Annual Report of the Interstate Commerce Commission.*

24 Interstate Commerce Commission v. A. M. Ry. Co. et al., 168 U. S. 144.

and conditions at Montgomery and at Troy, it was urged, as to justify a departure from the prohibition of the long-and-short-haul clause. The Commission, in accordance with its previous decisions, refused to recognize that the existence of competition between railways subject to the Act to Regulate Commerce created the necessary dissimilarity of circumstances and conditions. The Supreme Court set aside the ruling of the Commission and held that the higher rate at Troy did not constitute a violation of the fourth section.

The interpretation of the Supreme Court amounted to a repeal or nullification of the long-and-short-haul principle because it authorized the railways, without special consent of the Commission, to charge a higher rate for the shorter than for the longer distance in practically all cases in which the practice would be of any benefit from the standpoint of the railways, regardless of the public welfare. The Interstate Commerce Commission, in its annual report for 1897, distinguished clearly between its own view and the view of the court. In criticism of the Alabama Midland decision, the Commission said:

> The most superficial examination of the questions involved showed that as a matter of fact there was a broad difference between different kinds of competition as related to this question. The water carrier did not stand like the carrier by rail. The highway over which he operated cost him nothing. His vessels were comparatively inexpensive and could readily be transferred from place to place. The cost of carriage was ordinarily much less. Above all, he was not subject to the provisions of this Act. He was compelled to publish no rate, to respect no schedule; he was free to go into the market and to take whatever transportation he could obtain at whatever figure he chose. Manifestly there was no similarity between competition with this carrier

and competition with a railway subject to the provisions of the Act to Regulate Commerce. The same thing was true to a limited extent with railroads in foreign countries. The Canadian Pacific Railway could make any rate it chose from the Atlantic to the Pacific, could vary that rate at pleasure, and could fix its terminal rate without any reference to intermediate points. So also could a railroad situated wholly within a state, as to the traffic within that state.

ITS REHABILITATION

Between 1897 and 1910 the railways were virtually free to disregard the long-and-short-haul principle at will. The Commission was without adequate authority to enforce the fourth section of the Act. The agitation for the amendment of the long-and-short-haul clause, which began to take shape immediately after the Alabama Midland decision was rendered, finally bore fruit in the Mann-Elkins Act of 1910. One of the most important features of that legislation was the rehabilitation of the fourth section. The phrase "under substantially similar circumstances and conditions" was entirely stricken from the section. As a result, the railways are now forbidden to charge a higher rate for the shorter than for the longer haul under any conditions, without the prior consent of the Commission. Under this rehabilitated long-and-short-haul clause the Commission is engaged in effecting a readjustment of the southern and transcontinental rate structures in which disputes as to local discrimination have most frequently arisen.

Pooling and Discrimination

In conclusion it is necessary to recognize that the law against discrimination would gain in effectiveness through the repeal of the anti-pooling section of the Act

to Regulate Commerce. The policy of prohibiting pooling absolutely, even with the consent or under the supervision of the Commission, is inconsistent with and runs counter to the policy of eliminating discriminatory practices. Preferential treatment of favored shippers arises primarily through the exigencies of keen competition. The most effective check upon personal discrimination lies in the legal recognition of co-operative effort. With the large powers of regulation now vested in the Interstate Commerce Commission and in most of the state commissions, the legalization of pooling, under government control, would involve little danger of abuse and great possibilities of relief alike to the railways and to the public. The demand for the repeal of section five of the Act is both general and insistent. Only the deep-seated distrust of monopoly and of all arrangements that may lead to monopoly which is characteristic of the American mind stands in the way of translating this demand into legislative action.

TEST QUESTIONS

1. What is the fundamental cause of railway discrimination?
2. What is the distinction between just and unjust discrimination?
3. Discuss briefly discrimination between commodities.
4. Why is the problem of local discrimination so difficult of solution in many cases?
5. Why is personal discrimination generally without justification?
6. Mention some of the more common forms of personal discrimination.
7. What provisions against discrimination are made in the Act to Regulate Commerce?
8. Trace briefly the development of the long-and-short-haul clause.
9. Why would a repeal of the anti-pooling section of the Act tend to eliminate discrimination?

CHAPTER VIII

REGULATION BY THE STATES [1]

Modern railway regulation by the states is carried on primarily through administrative commissions, which commissions are usually vested with authority to regulate also public utilities other than railways. This chapter is devoted to a consideration of the nature and activities of these commissions. The following pages, therefore, include a discussion of public service and public utility commissions as well as railroad commissions, and of gas, electric, water, telephone, and telegraph companies as well as railroad companies. The principles of regulation are substantially alike for all these public utilities, and the authority to regulate all or a number of them is usually vested in the same commission, whether it be called a railroad, public service, or public utility commission.

The Methods of State Regulation

UNREGULATED MONOPOLY

In the early days of the development of public utility properties there was little or no regulation for the safeguarding of public welfare. In order to afford effective

[1] The substance of this chapter appeared under the title "Commission Regulation of Public Utilities: A Survey of Legislation," in the *Annals of the American Academy of Political and Social Science* for May, 1914, and is here reprinted by permission.

stimulus for inventive genius and business initiative, it was necessary to provide a free field for private enterprise, unhampered by legislative restriction. The technique of railway and utility operation, in which so high a degree of efficiency has since been attained, had yet to be worked out. The permanent necessity and financial practicability of these utility services, which have now been recognized beyond recall, had yet to be established.

In these monopolistic industries, as in private business, public welfare counseled a policy of non-interference. In spite of their monopolistic character, it was felt that the public service industries, in order to be ready for public control no less than for public ownership, must first have reached a stage of maturity consistent with the lessened opportunities for private gain necessarily involved in a system of effective public regulation. During the first half of the nineteenth century, therefore, franchise privileges were freely granted by the state legislatures. These franchises extended for long periods and often in perpetuity. As a result, the privileges essential for supplying the future, as well as the then-existing needs of the community were given to private corporations with little thought of immediate restriction, or of reservation of power for future regulation. The public service franchise was looked upon as a private contract between the state and the grantee corporation instead of as a permit by the sovereign for the performance by private individuals or corporations of functions largely public in their nature.

The regulation of public utilities may be said to have passed through three stages, not always entirely distinct,

from which emerge three different methods of public control:

1. Regulation through franchise provisions.
2. Legislative regulation.
3. Commission regulation.

REGULATION THROUGH FRANCHISE PROVISIONS

Regulation through the provisions of the franchise began during the second half of the nineteenth century when greater care came to be exercised in the drawing up and the granting of franchises. Exclusive grants were often prohibited by constitutional provision and statutory enactment. The unconditional long-term grant began to give way to the short-term franchise with restrictive provisions. Instead of grants in perpetuity or for ninety-nine, or even fifty, years, the life of the franchise came more generally to be from twenty-five to forty years. Moreover, the grantee was subjected to restrictions incorporated in the franchise. Maximum charges were often prescribed, particularly in the case of railroad and street-railway service, above which the grantee corporations could not go in fixing their rates and fares. There was often some provision, too, as to the character of the service to which the public would be entitled under the terms of the franchise.

This form of regulation had two fundamental drawbacks: in view of the rapid growth of the community, the restrictions contained in the grant did not provide adequate regulation even for the short period of the franchise; and there was no administrative machinery for the execution, on behalf of the public, of the limited restrictions of the franchise contract.

LEGISLATIVE REGULATION

The second form in which the movement for adequate regulation manifested itself was the reservation to the state of the general power of control. This reserved power of regulation, which was gradually extended by the courts as a power inherent in the state even in the absence of express reservation, was exercised by state legislatures through the enactment of statutes, and by city councils through the promulgation of municipal ordinances.

This method gave a fuller recognition to the permanence of the problems raised by the unregulated operation of the public service industries. It afforded a means for regular instead of periodic adjustment of the relations between the public and the public service corporations. It was defective, however, in several particulars. The lack of expert knowledge on the part of legislators and councilmen, together with the great diversity of their interests, often resulted in ill-advised or ineffective legislation. Moreover, the absence of permanent administrative machinery for carrying into effect the public policy embodied in the legislation aiming to regulate railroads and other public utilities, resulted in a control which was inevitably spasmodic and, at best, inadequate. This was the general situation toward the end of the nineteenth century.[2]

COMMISSION REGULATION

Regulation by the states through administrative commissions of the type that prevails today is very recent. The Railroad Commission of Wisconsin was not estab-

2 Even after commissions began to be used in place of direct legislative control the commissions for a long time were given little real power.

lished until 1905, and it was not given jurisdiction over utilities other than railroads, express companies, and telegraph companies till 1907. The Public Service Commissions of New York were not established till 1907. The Wisconsin and New York commissions have served, to a large degree, as models for the numerous administrative bodies for the state regulation of railroads and other public utilities that have sprung into being since 1907; and the Wisconsin and New York laws have been the basis of a large part of the public utility legislation recently enacted.

These laws substitute administrative regulation for direct legislative control. To special boards or commissions are entrusted large powers whereby they are enabled to keep themselves constantly and thoroughly informed of the practical operation as well as of the general policy of public service corporations. On the basis of this knowledge and information they exercise such supervision over these utilities as may tend to harmonize the private interests of the owners and the general welfare of the public. With but few exceptions, present-day regulation is legislative in character only in the sense that the extent of commission jurisdiction and power is determined by statutory enactment.

The Scope of Railroad and Utility Legislation

Now a complete summary of railroad and utility legislation would include, in addition to the so-called commission laws, all special franchises and charters, with such restrictions as they contain, and all direct legislation imposing duties upon utilities for the enforcement of which no provision is made. A comprehensive survey of commission legislation, even, would include many laws

whereby duties are imposed upon utilities by direct legislative enactment with power of enforcement vested in commissions.

This chapter deals almost exclusively with commission laws. Emphasis is here placed upon the organization and powers of commissions rather than upon the duties of utilities. Since the authority of the Interstate Commerce Commission extends primarily, if not entirely, to interstate business, it is given no consideration in this chapter, in spite of its large influence upon recent state commission legislation. Municipal commissions are obviously beyond the scope of this chapter. Although there has been considerable American experience with municipal commissions (usually deriving their direct authority from municipalities and exercising jurisdiction over utilities whose business is confined within these municipalities), the general trend of commission regulation seems to be toward the establishment of central commissions whose authority is state-wide, even for such utilities as are local in character. In the case of steam railways, the regulating machinery is exclusively state and national. In this place an analysis is undertaken of the commission laws of the state.

The Organization of Commissions

PERSONNEL AND ORGANIZATION

The success of commission regulation will depend largely upon the personnel of the commissions. Ultimately, the personnel of railroad and public service commissions will be determined by the attitude of the public toward its officials in general, and by the confidence or distrust which the public manifests towards the employment in the public service of trained experts and men of

large business experience. This is one of the fundamental problems of American democracy, and it cannot be solved by mere legislation. But the effectiveness of commission regulation depends in large measure also upon political machinery, and this leads to a consideration of the important legislative requirements dealing with commission organization and procedure.

There are at the present time forty-eight state commissions, with independent personnel, representing forty-five separate jurisdictions.[3] Delaware, Utah, and Wyoming are the only states which have no central commissions. New York, Massachusetts, and South Carolina have each two distinct commissions.

SELECTION OF COMMISSIONERS

The members of twenty-seven of the forty-eight commissions are appointed by the governor by and with the consent or advice of the senate or council; in one they are appointed by a railroad board, or a majority of its members, consisting of the governor, the lieutenant-governor, and the attorney-general; in twenty they are elected by the people. It is generally recognized that the appointive commission, all else being equal, is likely to call into the public service better and abler men than the elective commission. And there is a strong tendency towards the appointive commission. Not only is a clear majority of the commissions appointive, but all the states which legislated during the year 1913 created appointive commissions.[4]

[3] A complete list of the state railroad and public utility commissions will be found at the end of this chapter.

[4] Idaho, Illinois, Indiana, Massachusetts, Missouri, Montana, Ohio, Pennsylvania and West Virginia.

NUMBER OF COMMISSIONERS AND LENGTH OF TENURE

The number of commissioners varies from three to seven. Thirty-eight commissions have three members; one has four; eight have five; one has seven. The term of office varies from two years in Arkansas and North Dakota to ten years in Pennsylvania. In five jurisdictions the tenure is three years; in six, four years; in three, five years; in thirty, six years; in one, eight years. It is evident that a strong tendency exists to give the commissioners a tenure long enough to make them expert in their work, even if they are not so when they take office.

COMPENSATION OF COMMISSIONERS

The compensation of commissioners varies from $1,500 in South Dakota to $15,000 in New York. In one commission the salary is $1,700 per annum; in one, $1,900; in four, $2,000; in one, $2,200; in three, $2,500; in nine, $3,000; in one, $3,500; in nine, $4,000; in two, $4,500; in four, $5,000; in one, $5,500; in four, $6,000; in one, $7,500; in one, $8,000; in two, $10,000; and in two, $15,000. It will be noted that in fifteen commissions the salaries are $5,000 or over and in thirty-three they are less than $5,000. In nine commissions they are less than $2,500. In the recent legislation, however, the tendency is to provide a reasonably adequate salary for the commissioners. Illinois and Pennsylvania, for example, in their new laws, provide a salary of $10,000 for each of the commissioners; Massachusetts, $8,000; Ohio, Indiana and West Virginia, $6,000; Missouri, $5,500; and Idaho, $4,000.

SUBORDINATE OFFICIALS AND ADMINISTRATIVE STAFF

In addition to the commissioners, provision is often made in the statutes for a secretary or clerk and for a special attorney to the commission. Such provision for a secretary or clerk is found in thirty-five jurisdictions, and for a special attorney in twenty-two jurisdictions. In some states the attorney-general is directed to act on behalf of the commission and to appoint such other counsel as may be necessary. In thirty jurisdictions the salary of the secretary or clerk is fixed by statute, varying from $1,200 to $6,000. In nine jurisdictions the salary of the attorney to the commission is fixed by statute, varying from $2,500 to $10,000.

In most of the jurisdictions it is further provided that the commission may employ such subordinates as it deems essential for the adequate performance of its duties. The following provision from the recent Massachusetts public service commission law indicates the general tendency of commission legislation in the matter of subordinate employees:

> The commission may appoint or employ such engineers, accountants, statisticians, bureau chiefs, division heads, assistants, inspectors, clerks, and other subordinates as it may deem advisable on such terms of office or employment and at such salaries as it may deem proper.[5]

QUALIFICATIONS OF COMMISSIONERS

In eight jurisdictions commissioners must have special qualifications prescribed by statute. In Georgia one of the commissioners must be experienced in law, and one in the railroad business; in Kansas one must be "a practical experienced business man," and one experienced

[5] Acts 1913, chap. 784, § 9.

in the management or operation of a common carrier or public utility; in Maine the chairman must be learned in law, one of the commissioners must be a civil engineer experienced in the construction of railroads, and one experienced in the management and operation of railroads; in Michigan one must be an attorney having a knowledge of and experience in the law relating to common carriers, and the other two must have a knowledge of traffic and transportation matters; in Nevada the chief commissioner must be an attorney at law well versed in the law of railroad regulation, the first associate commissioner must be a practical railroad man familiar with the operation of railroads, and the second associate must have a general knowledge of railroad fares, freights, tolls and charges; in Virginia at least one commissioner must have the same qualifications as are required for judges of the supreme court of appeals; in West Virginia one of the commissioners must be a lawyer of not less than ten years' actual experience at the bar; and in Wisconsin one must have a general knowledge of railroad law, and each of the others must have a general understanding of matters relating to railroad transportation. In two jurisdictions the qualifications are very general in character. The new Massachusetts public service law provides that each of the commissioners shall be "a competent person"; and in South Carolina it is provided that the members of the public service commission shall be "reputable and competent citizens of South Carolina."

DISQUALIFICATIONS FOR MEMBERSHIP

Most jurisdictions provide certain disqualifications for membership in a railroad or pubilc utility commission. The disqualification provisions of forty jurisdictions, stated in composite form, provide that no person em-

ployed by, or connected with, or holding any official relation to, or owning stocks or bonds of, or having any direct or indirect or pecuniary interest in any public utility over which the commission has jurisdiction, or of the kind over which the commission has jurisdiction, is eligible to membership in the commission. In Wisconsin it is provided that no person who has a pecuniary interest in any railroad or telegraph or express company in Wisconsin or elsewhere may become a member of the commission. In twenty-six jurisdictions it is further provided that no commissioner, officer, or employee of the commission may engage in any other business, employment, or vocation, or hold any other political office. In Idaho and West Virginia the prohibition extends only to any other political office.

COMMISSION PROCEDURE

The determination of rules of procedure and practice is largely in the hands of the commission. In two-thirds of the jurisdictions authority is specifically conferred upon the commissions to adopt rules and regulations for their government and proceedings. It is usually provided, however, that all hearings must be open to the public, and that any party in interest may be heard in person or by attorney. On the other hand, authority is almost universally given to the commissions to administer oaths, subpœna witnesses, and order the production of books, records, and memoranda in proceedings held before them. Investigations and hearings are commonly started on complaint, but it is often provided that the commission may make summary investigations and hold hearings on its own motion or initiative and issue orders on the basis of its findings.

The General Extent of Commission Authority

NUMBER AND GROWTH OF COMMISSIONS

The general extent of commission authority may be examined from three points of view. First, the scope and trend of regulation may be gathered from the number of commissions in existence and the rapidity of their growth. There are today, as already indicated, forty-eight state commissions representing every state but Delaware, Utah, and Wyoming. No less than thirty of these either came into existence since 1907 or have been so completely changed in character since 1907 that they are practically new commissions. Early in 1913 the National Civic Federation completed a comprehensive compilation and analysis of laws for the regulation of public utilities by central commissions.[6] In the short time that has elasped since the results of that investigation were published, public service commissions have been created in two states, Idaho and West Virginia, where no utility commissions had before existed, and seven other states have passed complete public service laws now in operation. In addition there has been a mass of amendatory legislation whereby existing commissions have been very largely transformed.

JURISDICTION OF COMMISSIONS

The extent of commission authority may be gaged also by the kind and number of utilities which may be reached in any way by the railroad and utility commissions. The

6 "Commission Regulation of Public Utilities: A Compilation and Analysis of Laws of Forty-three States and of the Federal Government for the Regulation by Central Commissions of Railroads and Other Public Utilities." The National Civic Federation, Department on Regulation of Interstate and Municipal Utilities, New York, 1913.

state commissions collectively have some degree of authority over corporations, companies, associations, joint-stock companies, partnerships, or individuals that own, operate, manage, or control steam railroads, electric and street railroads, interurban or suburban railroads, elevated railroads or subways, automobile railroads, steamboats and other water craft, express lines and messenger lines, signalling facilities, bridges, and ferries connected with railroads, pipe lines for the transportation of oil or water, sleeping, parlor, and drawing-room cars, terminals, union depots, docks, wharves, storage elevators, fast freight lines, stage lines, messenger service, telegraphs and telephones, irrigation and sewage facilities, and facilities for the manufacture and sale of gas, electricity, heat, light, water, power, hot or cold air, and steam.

Whether a given business constitutes a public service undertaking depends largely upon the social and industrial conditions that prevail in the community. Whether, upon recognition of a given undertaking as a public service industry, express authority to regulate shall be granted to commissions, depends usually upon the public policy of the given community and more particularly upon the political conditions prevailing in that community. The utilities to which commission jurisdiction extends, therefore, vary greatly in the different states; but the principles of adequate regulation, as embodied in the various powers conferred upon commissions, are found to depend but very slightly upon the number and nature of the utilities regulated. This is but a recognition that public service industries may, in most respects, be treated as a homogeneous class.

A distinction is often made between interstate and municipal utilities, or between railroads and other public

utilities. Commission legislation but seldom distinguishes to any striking degree between these classes of utilities, although there is considerable variety in the names of the commissions. Twenty-two of them are railroad commissions; twelve are public service commissions; seven are public utility commissions; five are corporation commissions; one is a railroad and warehouse commission; and one is a board of gas and electric light commissioners. The names of the commissions do not always indicate the scope of their jurisdiction. Many of the railroad commissions have jurisdiction over the so-called municipal utilities; as, for example, the railroad commissions of Oregon and Wisconsin. Most of the public utility or public service commissions have jurisdiction over railroads; as, for example, the Massachusetts and New York commissions.

ADVISORY VERSUS MANDATORY COMMISSIONS

Finally, the extent of commission jurisdiction may be gathered from the powers vested in the commissions. Two types of regulating boards have appeared in American experience: the advisory board, with powers of investigation and recommendation, of which the old Massachusetts railroad commission is the most notable example; and the mandatory board, with power to order as well as to recommend, of which the New York and Wisconsin commissions are perhaps the best examples. The advisory commission relies upon publicity and the strength of public opinion for the enforcement of its recommendations; the mandatory commission is vested with sufficient power to compel the utilities to submit to its orders.

The advisory commission has been abandoned even in Massachusetts. Large powers are now granted to the

commissions; the duty of utilities to comply with the orders of the commissions is clearly stated; the commissions are given authority to invoke judicial process for the enforcement of their orders, and usually penalties, varying in stringency, are imposed upon utilities for failure to comply with these orders. Since the enactment of the Wisconsin railroad commission law in 1905 and of the Hepburn amendments to the Act to Regulate Commerce in 1906, practically all utility legislation has proceeded on the basis of clothing commissions with ample power to exercise continuous supervision over railroads and other public utilities and to afford effectual relief to any party in interest whenever necessary. The authority to prescribe just and reasonable rates, therefore, is almost universally enjoyed by the modern type of railroad or public service commission.

GENERAL GRANTS OF AUTHORITY

In addition to such specific powers as are necessary for adequate public control, commissions now possess large general powers of investigation and supervision over the property and business of public utilities. This general power of regulation is stated in most comprehensive fashion in the Illinois public utilities commission law, as follows:

> The commission shall have general supervision of all public utilities, shall inquire into the management of the business thereof and shall keep itself informed as to the manner and method in which the business is conducted. It shall examine such public utilities and keep informed as to their general condition, their franchises, capitalization, rates and other charges, and the manner in which their plants, equipments and other property owned, leased, controlled or operated are managed, conducted and operated, not only with respect to the adequacy,

security and accommodation afforded by their service, but also with respect to their compliance with the provisions of this act and any other law, with the orders of the commission and with the charter and franchise requirements.[7]

The following provision of the Wisconsin public utilities act is found in most jurisdictions, and further indicates the nature of the general powers vested in commissions, so far as they are essential to a proper performance of their duties:

> The commission or any commissioner or any person or persons employed by the commission for that purpose shall, upon demand, have the right to inspect the books, accounts, papers, records, and memoranda of any public utility and to examine, under oath, any officer, agent, or employee of such public utility in relation to its business and affairs.[8]

We may now present a brief review of the more important specific powers vested in railroad and public utility commissions.

The Regulation of Franchises

Objects of franchise regulation

The important provisions in commission laws looking to franchise regulation aim to prevent unnecessary duplication of utility properties through the introduction of competition where the public welfare demands the recognition of monopoly, and to provide for the uninterrupted operation of utilities, under adequate control of rates and service, subject to public purchase whenever such private operation ceases to promote the public good.

7 Acts 1913, House Bill No. 907, § 8.
8 Laws 1907, chap. 499, § 1799m-38.

CERTIFICATES OF CONVENIENCE AND NECESSITY

The first of these purposes has been accomplished by requiring the issue of a certificate of convenience and necessity by the commission before a public utility may enter upon a new undertaking, or extend an existing undertaking, or exercise franchise privileges previously granted but not theretofore exercised. The essential elements of the certificate of convenience and necessity are stated as follows in the New Hampshire public service commission law:

> No public utility shall commence within this state the business of transmission of telephone or telegraph messages, or of supplying the public with gas, electricity or water, or shall engage in such business or begin the construction of a plant, line, main, or other apparatus or appliance intended to be used therein in any city or town in which at the time it shall not already be engaged in such business, or shall exercise any right or privilege under any franchise hereafter granted (or any franchise heretofore granted, but not heretofore actually exercised) in such town, without first having obtained the permission and approval of the commission. The commission shall grant such permission whenever it shall, after due hearing, determine and find that such engaging in business, such construction or such exercise of the right, privilege or franchise would be for the public good and not otherwise; and may prescribe such terms and conditions upon the exercise of the privilege granted under such permission as it shall consider for the public interest. Authority granted under the provisions of this section may only be exercised within two years after the same shall be granted, and shall not be exercised thereafter.[9]

Provisions substantially identical with the New Hampshire section are found in nineteen jurisdictions.[10] It is

9 Laws 1911, chap. 164, § 13 (a).

10 Arizona, California, Connecticut, Idaho, Illinois, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Missouri, New Hampshire, New York, Pennsylvania, South Dakota, Vermont, West Virginia and Wisconsin.

to be noted that practically all the states which passed complete laws during 1913 provide for certificates of convenience and necessity.

INDETERMINATE FRANCHISES

The other purpose of the franchise provisions of commission laws is to recognize the essentially monopolistic character of public utilities by providing for their continuous operation, during good behavior, under a permit unlimited as to time, with power in the public authorities to exercise an option of purchase. The indeterminate franchise was first established in Massachusetts, where street railway locations may be revoked by local authorities (the revocation being subject to approval by the commission in certain cases) at any time after the expiration of one year from the date of the franchise.

The most thorough-going indeterminate franchise law is to be found in Wisconsin. It was enacted in 1907 and materially amended in 1911. It provides for indeterminate permits for street railways and for heat, light, water, and power companies in municipalities. The indeterminate permit was first to apply to all future grants, with authority for companies operating under limited-term franchises to exchange them for indeterminate permits. The amendment of 1911 provided that all franchises theretofore granted were to become indeterminate.

The essential characteristics of the principle of indeterminate franchises are: first, that the public service corporation is recognized as a legal monopoly, and no permit is granted to a competing company, unless public convenience and necessity require such grant; and second, that the public service company, in accepting an indeterminate permit, consents to the purchase of its plant by the municipality in which it operates. The purchase

price is to be fixed by the commission, subject to review by the courts. The new public service commission law of Indiana provides for indeterminate permits similar to those established in Wisconsin.

The Regulation of Security Issues

In fifteen jurisdictions the commission has authority to supervise the issue of stocks and bonds.[11] In some of these jurisdictions the commission's power is stated in general terms and does not provide for a strict control of capitalization. The New Jersey law, for example, merely provides that no public utility shall "issue any stocks, stock certificates, bonds or other evidences of indebtedness payable in more than one year from the date thereof, until it shall have first obtained authority from the board for such proposed issues. It shall be the duty of the board, after hearing, to approve of any such proposed issue maturing in more than one year from the date thereof, when satisfied that the same is to be made in accordance with law and the purpose of such issue be approved by said board."[12]

In many of the states, however, the commission has complete control, definite financial standards being prescribed and provisions being made for thorough investigation and valuation by the commission before approval of security issues, and for detailed supervision of the disposition of the proceeds after the commission's certificate has been granted. The most valuable experience in the regulation of security issues is to be found in New York, Massachusetts, Texas, and Wisconsin. The Wis-

11 Arizona, California, Kansas, Illinois, Indiana, Massachusetts, Michigan, Missouri, New Hampshire, New Jersey, New York, Pennsylvania, Texas, Vermont and Wisconsin.

12 Laws 1911, chap. 195, § 18 (e).

consin stock and bond law, for example, applying to railroads and to street railway, telegraph, telephone, express, freight line, sleeping-car, light, heat, water and power corporations, establishes a comprehensive system of regulating security issues by commission. It affords a practical guarantee by the state that there is an equivalence between the amount of outstanding securities and the investment upon which the utilities are entitled to a fair return. Legislation of similar scope may be found in five other states, three of which legislated during the year 1913.

The Regulation of Rates and Service

Commission laws lay down the foundations of rate-making, or the requisites of lawful rates, prohibit unjust discrimination, prescribe publicity in the making of rates and schedules, and vest in commissions the power to fix rates in accordance with the principles thus prescribed.

FOUNDATIONS OF RATE-MAKING

It is almost invariably provided that rates and charges shall be just and reasonable, and the commissions are given authority to enforce the standard thus established. In many jurisdictions the various elements that must be considered and the various devices that may be adopted in the establishment of reasonable rates by utilities and commissions are further prescribed.

The chief elements emphasized by the statutes for lawful rates are that a due regard be accorded "to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservation out of income for surplus and con-

tingencies."[13] Twenty-four jurisdictions make express provision for the valuation of the property of railroads and other public utilities by commissions.[14] These valuations are sometimes used for capitalization and purchase as well as for rate-making purposes. The tendency in these valuation provisions is to vest in the commissions ample power for the successful ascertainment of the investment value. Such elaborate valuation provisions may be found in Ohio, Pennsylvania, Washington, and Wisconsin.

The main device provided by statute through which reasonable rates may be assured is the sliding scale, chiefly applicable to the gas industry, but also, in some cases, to electric companies. The sliding scale method of regulating rates is a device by means of which rates automatically decrease as profits increase. For example, the price of gas may be fixed at 85 cents per thousand cubic feet and the dividend rate at that price may be limited to 7 per cent. For every decrease of 5 cents per thousand in the price of gas, the dividend rate increases 1 per cent. Thus both the public and the public service corporation share in the profits resulting from increased economies of production. In addition to the Boston sliding-scale act in Massachusetts, nine jurisdictions authorize utilities to establish the sliding scale for the automatic adjustment of charges and dividends under commission supervision.[15]

13 New York: Laws 1910, Ch. 480, § 97.

14 Arizona, Arkansas, California, Florida, Georgia, Illinois, Indiana, Kansas, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Jersey, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Texas, Washington, West Virginia, Wisconsin.

15 Arizona, California, Idaho, Maryland, Missouri, New York, Ohio, Pennsylvania, Wisconsin.

DISCRIMINATION IN RATES AND SERVICE

The laws regularly provide also that unjust discrimination is prohibited, and the commissions are given authority to enforce the prohibitions. Unjust discrimination is variously defined. As defined in the commission laws collectively, it comprises the following acts:

(1) Charging a greater or less compensation to one person than to another for like and contemporaneous service;

(2) Charging rates other than those prescribed by law or specified in published schedules, refunding, remitting, or rebating any portions of such rates, or extending privileges or facilities not uniformly open to all;

(3) Charging a less compensation in consideration of the furnishing by utilities of any part of the facilities incident to the service;

(4) Charging a less compensation in consideration of the size of the shipment or the extent of the service;

(5) Charging a greater compensation for a shorter than for a longer distance, or for a smaller than for a larger service;

(6) Granting to any person, corporation, locality, or any particular description of service, any undue or unreasonable preference or advantage, or in subjecting the same to any undue or unreasonable prejudice or disadvantage;

(7) Assisting or permitting patrons to secure special favors or advantages, or rates other than those lawfully established;

(8) Soliciting, accepting or receiving special favors, or advantages, or rates other than those lawfully established.

There are also general prohibitions against offering,

granting, soliciting, or accepting free or reduced rate or special service, with elaborate lists of exceptions; special prohibitions applicable to public officials and members of political organizations; and requirements that lists of persons to whom free or reduced rate or special service has been granted shall be published and filed with the commission. The provisions also indicate the kinds of special treatment which constitute justifiable discrimination and authorize the commissions to determine under what conditions such circumstances exist as make discrimination justifiable.

PUBLICITY REQUIREMENTS

Again, it is almost invariably required that utilities submit to full publicity in the establishment and change of their rates and schedules, and authority is vested in the commissions to render publicity in rate-making effective. Utilities are thus ordered to file their schedules of rates with the commissions, after due notice of their adoption; the matters to be contained in these schedules are prescribed in detail; the forms of schedules are made subject to the approval of the commissions; it is provided that the schedules be published and posted; the filing, publishing, and posting of rate schedules is often made a condition precedent to the exercise by utilities of the right to do business; and utilities, in many instances, are required to file with the commissions copies of leases, contracts, and arrangements made with other utilities.

ESTABLISHMENT AND CHANGE OF RATES

The important powers as to rates are found in the provisions which authorize commissions to regulate or prescribe the rates and charges of railroads and other public utilities, establish the procedure to be followed

in the exercise of these powers, and indicate the legal effect to be given to the rates and charges so established. All the states now give the commissions mandatory powers over rates. In many of the jurisdictions there is language so broad that it may, by liberal interpretation, be construed to vest in the commissions power to fix rates in the first instance. When the legislation in each jurisdiction is taken as a whole, however, the authority of the commissions in practically all the commission states is limited to the power on its own motion or on complaint, after investigation, to declare rates and charges previously in force to be unreasonable, and to prescribe others in lieu thereof to be followed in the future. In other words, in spite of the large power over rates vested in commissions, the right to initiate rates is practically everywhere reserved to the railroads and other utilities; but in about one-third of the jurisdictions the commissions are given the additional authority to suspend the operation of rates fixed by railroads and other utilities pending an investigation as to their reasonableness undertaken by the commissions. In some jurisdictions the rates fixed by commissions are considered *prima facie* lawful and in force until found unreasonable upon review by a proper court; in some states their operation is suspended until declared reasonable upon judicial review.

ADEQUACY AND SAFETY OF SERVICE

Many of the rate provisions, in so far as they empower commissions to supervise the business of utilities, apply to regulations, practices and service. But while more than one-half of the states provide that the service furnished by utilities must be reasonable, or that the facilities must be adequate and safe, only about one-third of

the commission jurisdictions vest sufficient authority in the commissions to render these requirements effective.

The practice in the past has been to establish by direct legislative enactment absolute standards of service and safety, together with specific facilities and safety appliances. The present tendency, however, as evidenced by much of the recent legislation,[16] is to clothe commissions with power over service and facilities, both as to adequacy and as to safety, commensurate with their power over rates. The more recent commissions, therefore, are authorized to prescribe reasonable service standards and to provide for such inspection and testing of service and facilities as will insure their adequacy and safety.

The Regulation of Accounts and Reports

The regulation of accounts and reports serves to provide for commissions the data essential to an adequate control of capitalization, rates and service.

ACCOUNTING PRACTICES

There are provisions for the regulation of accounts in twenty-eight jurisdictions. The most general requirement is that by which authority is granted to commissions to establish a system of uniform accounts for public utilities, with power to prescribe the forms of accounts, records, and memoranda, and to indicate the manner in which they shall be kept, or to classify public utilities and establish a system of accounts and prescribe forms for each class. In most jurisdictions this power may be exercised at the discretion of the commission. Sometimes, as in the new Indiana law, the authority to pre-

16 Idaho, Illinois, Indiana, Missouri, Pennsylvania and West Virginia.

scribe accounting practices is made mandatory upon the commission. In a number of the jurisdictions it is further made unlawful for utilities to keep any other accounts, records, or memoranda than those prescribed or approved by the commission. In the case of railroads and other common carriers, the commissions are often specifically required to conform, as far as possible, to the system of accounts established and prescribed from time to time by the Interstate Commerce Commission.

In about one-fourth of the states—Arizona, California, Idaho, Illinois, Indiana, Missouri, New Jersey, Ohio, Oregon, Pennsylvania and Wisconsin—special depreciation accounts are provided for. The commission is empowered to require proper and adequate depreciation or deferred-maintenance accounts to be kept in accordance with prescribed forms and regulations, whenever it shall determine that depreciation accounts can reasonably be required.

Moreover, the commissions are given authority to examine as well as to prescribe accounts—that is, the commission or the commissioners, or their duly authorized agents or examiners, may have access to the accounts of the utilities and may at all reasonable times examine and inspect them. Heavy penalties are usually imposed for violations of accounting provisions.

REPORTS AND STATISTICS

The duty is almost invariably imposed upon utilities to transmit to the commission, at specified intervals or at such time as the commission may designate, regular reports of their doings setting forth such facts, statistics, and particulars relative to their business, receipts, and expenditures as may be required by the commission. In many states special reports may also be called for by

the commission at different intervals. It is often provided that the commission shall furnish blank forms for regular or special reports, and the reports must be duly sworn to or verified by such officers or persons as the commission may designate. Full and specific answers must be given to all questions propounded by the commission, or sufficient reasons must be stated for failure to make such answers. In case the reports or returns appear to be defective or erroneous, the commission is usually given the power to order their amendment within a specified time. It was very common in the older utility laws, particularly for the regulation of railroads and common carriers, to prescribe by statute the detailed contents of annual reports; but in pursuance of the general trend of giving commissions ample discretion in the regulation of utilities, the more advanced legislation, including most of the recent laws, vests complete power in the commissions as to the scope of the reports to be made by railroads and other utilities. Heavy penalties are usually imposed for the violation of provisions relating to reports and statistics.

State Versus Federal Regulation

The policies, principles, and rules of administrative public control analyzed and examined in the preceding pages were applied by the states to the regulation of railways long before they were generally extended to the supervision of other public utilities. In the course of time, however, with the growth of railway mileage and the development of interstate traffic, railway enterprise came to exert a larger and larger national influence and its problems came to be considered national problems in constantly increasing measure. A system of federal

regulation of railways, the character of which will be considered in a later chapter, inevitably followed, and the activities of the state railroad and public service commissions began to be extended to the so-called local or municipal utilities. The gradual extension of the jurisdiction of the state commissions did not result, however, in a relinquishment of their authority over railroads. The railways came to be regulated, therefore, by the twofold agencies of the nation and the states, and their respective spheres of action began to be marked out by the enactments of our legislatures and the decisions of our courts. The problems involved in the conflict between state and federal authority which gradually developed are considered in the next chapter.

List of State Railroad and Public Service Commissions

The following is a complete list of state railroad and public service commissions. It is unnecessary, for the purposes of this text, to present an exhaustive list of constitutional and statutory sources; but all the more important commission laws are given, and reference is made to such other provisions as deal with the creation and organization of commissions.

Alabama: Railroad Commission of Alabama (Code 1907, §§ 5632, 5633, 5636, 5637, 5640, 5642).

Arizona: Corporation Commission (Session Laws 1912, chap. 90).

Arkansas: Railroad Commission of Arkansas (Kirby's Digest 1904, §§ 6788, 6789, 6793).

California: Railroad Commission of the State of California (Statutes 1911, 1st Extra Session, chaps. 14, 40).

Colorado: Public Utilities Commission of Colorado (Laws 1910, Special Session, chap. 5).

Connecticut: Public Utilities Commission (Public Acts 1911, chap. 128).

Florida: Railroad Commissioners for the State of Florida (Gen. Sts. 1906, §§ 2882, 2883, 2887—as amended 1907).

Georgia: Railroad Commission of Georgia (Code 1911, §§ 2616, 2620, 2621, 2622, 2625. Acts 1878-79, No. 269, § 1).

Idaho: Public Utilities Commission of the State of Idaho (Session Laws 1913, House Bill No. 21).

Illinois: State Public Utilities Commission (Acts 1913, House Bill No. 907).

Indiana: Public Service Commission of Indiana (Acts 1913, House Bill No. 361).

Iowa: Board of Railroad Commissioners (Code 1897, §§ 2111, 2121).

Kansas: Public Utilities Commission (Gen. Sts. 1909, § 7185. Laws 1911, chap. 238).

Kentucky: Railroad Commission (Constitution, § 209. Carroll's Statutes 1909, §§ 821-823).

Louisiana: Railroad Commission of Louisiana (Constitution, Arts. 283, 287, 289).

Maine: Public Utilities Commission (Rev. Sts. 1903, chap. 51, § 48—as amended by Public Laws 1909, chap. 141; chap. 116, § 1).

Maryland: Public Service Commission (Laws 1910, chap. 180. Laws 1912, chap. 563).

Massachusetts: Board of Gas and Electric Light Commissioners. (Rev. Laws 1902, chap. 121, § 1—as

amended by Acts 1907, chap. 316. Acts 1910, chap. 539, § 1); Public Service Commission (Acts 1913, chap. 784).

Michigan: Michigan Railroad Commission (Public Acts 1909, No. 300).

Minnesota: Railroad and Warehouse Commission (Rev. Laws 1905, §§ 1953 and 1956—as amended by Laws 1911, chap. 140; 1961).

Mississippi: Mississippi Railroad Commission (Code 1906, §§ 4826, 4828, 4830).

Missouri: Public Service Commission (Public Service Commission Law of March 17, 1913).

Montana: Railroad and Public Service Commission (Public Service Commission Law of 1913).

Nebraska: Nebraska State Railway Commission (Cobbey's Annotated Statutes 1909, §§ 10649, 10650).

Nevada: Railroad Commission of Nevada (Statutes 1907, chap. 44—as amended by Statutes 1911, chap. 193); Public Service Commission of Nevada (Statutes 1911, chap. 162). The personnel of the two commissions is the same, the railroad commission being ex officio the public service commission.

New Hampshire: Public Service Commission (Laws 1911, chap. 164).

New Jersey: Board of Public Utility Commissioners (Laws 1911, chap. 195).

New Mexico: State Corporation Commission (Constitution, Art. XI, § 1. Laws 1912, chap. 78).

New York: Public Service Commission, First District (Laws 1910, chap. 480—as amended through 1913); Public Service Commission, Second District (Same citation as for First District Commission).

North Carolina: Corporation Commission (Pell's Revisal 1908, §§ 1054-1056, 1060, 2754).

North Dakota: Board of Railroad Commissioners of the

State of North Dakota (Constitution, § 82; Rev. Codes 1905, §§ 364, 366, 367. Laws 1909, chap. 216, § 4).

Ohio: Public Utilities Commission of Ohio (Laws 1911, No. 325. Laws 1913, House Bill No. 582).

Oklahoma: Corporation Commission (Constitution, Art. IX, §§ 15, 16, 18(a). Constitution Schedule, § 15).

Oregon: Railroad Commission of Oregon (Gen. Laws 1907, chap. 53. Gen. Laws 1911, chap. 279).

Pennsylvania: Public Service Commission of the Commonwealth of Pennsylvania (Laws 1913, No. 854).

Rhode Island: Public Utilities Commission (Acts 1912, chap. 795).

South Carolina: Railroad Commission (Constitution, Art. IX, § 14. Gen. Sts. 1902, §§ 2063, 2064. Laws 1893, No. 304, § 1. Laws 1910, No. 286).

South Dakota: Board of Railroad Commissioners of the State of South Dakota (Rev. Pol. Code 1903, §§ 186, 187, 189-191, 194, 195—as amended by Session Laws 1907, chap. 208).

Tennessee: Railroad Commission of the State of Tennessee (Acts 1897, chap. 10. Acts 1907, chap. 390).

Texas: Railroad Commission of Texas (Constitution, Art. XVI, § 30. Sayles' Civil Statutes 1897, Art. 4561).

Vermont: Public Service Commission (Pub. Sts. 1906, §§ 4591, 4592, 6172. Laws 1908, No. 116).

Virginia: State Corporation Commission (Constitution, § 155).

Washington: Public Service Commission of Washington (Laws 1911, chap. 117).

West Virginia: Public Service Commission (Public Service Commission Law of February 20, 1913).

Wisconsin: Railroad Commission of Wisconsin (Laws 1905, chap. 362 as amended. Laws 1907, chap. 499 as amended, 454, 578. Laws 1911, chap. 593. Laws 1913, chap. 756).

TEST QUESTIONS

1. Why was there little or no regulation of public utilities in the early days?
2. Indicate the chief methods of state regulation and explain the distinctive characteristics of each.
3. Why must the success of commission regulation depend largely upon the personnel of the commissions?
4. What circumstances affect the appointment of railroad and public service commissioners?
5. State briefly the general tendencies which prevail in the method of selection of commissioners, their compensation, the number of commissioners, and the length of their term of office.
6. What provisions are usually found in regard to subordinate officials and administrative staffs?
7. Indicate the character of the qualifications for membership in a railroad or public utilities commission which are generally prescribed by statute. What are the usual disqualifications?
8. In what way are the rules of procedure and practice before the commissions usually determined?
9. From what three view points may extent of commission authority be examined?
10. What two types of regulating boards are found in America? Which is the prevailing type today?
11. What are the objects of franchise regulation? In what way are these objects attained through certificates of convenience and necessity, and the indeterminate franchise?
12. What are the purposes of state regulation of security issues? In what states are the most effective systems of financial regulation to be found?
13. What are the general provisions of commission laws as to the authority given to the commission in the adjustment of rates?
14. Explain the function of valuation provisions in the regulation of rates and service.
15. What is meant by the term "sliding scale" in connection with reasonable rates? Explain the principles involved in the sliding scale, and state to what utilities the sliding scale is usually made applicable.
16. Indicate the general character of the provisions against discrimination in rates and service, the requirements of rate

publicity, and the rules for the establishment and change of rates. Show the relationship between these provisions.

17. Compare the extent of commission authority in the establishment and change of rates with the scope of administrative power over the adequacy and safety of service.

18. Why is the regulation of accounts and reports necessary to an adequate control of capitalization, rates, and service?

19. State the important accounting provisions and those pertaining to reports and statistics which are generally found in state commission legislation.

CHAPTER IX

THE CONFLICT BETWEEN STATE AND FEDERAL AUTHORITY

In regulating interstate utilities, and particularly in the regulation of railways, the states have come into conflict with the authority of the federal government. This conflict in jurisdiction is but part of the larger question of the general distribution of governmental power between the nation and the states under our constitutional system, which presents one of the largest and most important problems in the development of American constitutional law. In this place it will be treated very briefly.

Distribution of Power Between the Nation and the States

In addition to the limitations upon national and state action which we have already considered,[1] resulting from the provisions of the Fifth[2] and Fourteenth[3] Amendments to the Federal Constitution, it is provided in the fundamental law of the land that Congress shall have power "to regulate commerce with foreign nations and among the several states,"[4] and that "the powers not

[1] See *supra*, pp. 95-110.

[2] "No person shall . . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation."

[3] ". . . nor shall any state deprive any person of life, liberty, or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws."

[4] Article I, Section 8.

delegated to the United States, by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."[5] These provisions seem to indicate clearly the respective spheres of state and national action. The binding force of this distribution of power is further emphasized by the clause providing that the "Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land, and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding."[6]

Under these provisions, then, Congress may exercise only such powers as are specifically delegated to it; and all powers not expressly delegated to Congress or prohibited to the states may be exercised by the state legislatures. Moreover, within the sphere of its delegated powers Congress is supreme, and its enactments prevail over all administrative and legislative acts of the states touching upon the same subject-matter. This sovereignty of the national government, to use the words of Chief Justice Marshall, "though limited to specified objects, is plenary as to those objects."[7] In the regulation of railways, therefore, exclusive power over interstate traffic—that is, the transportation of persons or the carriage of goods in the course of which state lines are crossed—is vested in the federal government, acting through Congress or the Interstate Commerce Commission; and full power over intrastate commerce—that is, the transportation of persons or the carriage of goods

[5] Tenth Amendment.

[6] Article VI, Paragraph 2.

[7] Gibbons v. Ogden, 9 Wheat. (U. S.) 1.

which begins and ends within the borders of a single state—is vested in the states, acting through their legislatures or railroad and public service commissions.

Intrastate and Interstate Commerce

It is very difficult, however, if not impossible, to make a distinct separation, for purposes of government regulation, between intrastate and interstate commerce. American railways almost uniformly carry both intrastate and interstate traffic. State boundaries are but artificial political lines and do not coincide with the natural channels of trade and industry. In the last quarter of a century, moreover, the growth of national or interstate business has far outstripped the development of local or intrastate business; and the conditions of intrastate and interstate commerce have become inextricably interwoven. The adjustment of intrastate rates, therefore, has come to exert a constantly increasing influence upon the development of the interstate rate structure. In part, this result has been indirect and inevitable, arising from the very close relationship which naturally subsists between local and interstate traffic; but in large measure it has been direct and purposeful, arising from the desire of individual states to secure through special regulations commercial advantages for themselves at the expense of neighboring states and the general trend of interstate commerce. In a very real sense, therefore, the states may be said to make interstate rates.[8] As a result, the problem of how far, in the control of railway rates, the supervision by the states of

[8] Robert Mather, "How the States Make Interstate Rates," *Annals of the American Academy of Political and Social Science*, 1908. Reprinted in W. Z. Ripley, *Railway Problems*, revised edition, 530.

their internal commerce has served to regulate and burden interstate commerce, has come to be one of the important and acute questions before the Supreme Court of the United States. The commerce clause of the Constitution has had to be re-interpreted in the light of modern conditions and recent practices, and the scope of federal authority over intrastate rates has had to be re-formulated.

Judicial Interpretation of the Commerce Clause

The present-day judicial interpretation of the commerce clause of the Constitution is the result of more than a century of development. Its virile roots are to be found in the famous opinion of Chief Justice Marshall in Gibbons v. Ogden,[9] decided in 1824. In the course of this century of growth, the American nation has secured internal unity and has achieved external expansion. Social, political, and economic changes of a revolutionary character have been gradually absorbed by the vigorous spirit of our national life. These changing conditions have brought changing interpretations of the distribution of governmental power between the nation and the states, each new application being grounded in the underlying principles of our constitutional law and presenting a continuous process of development.

To trace in detail the course of this development, even if the analysis were limited to the problem of railway regulation, is beyond the scope of this text. It will be profitable, however, to quote the *conclusions* from a re-

[9] 9 Wheat. (U. S.) 1.

cent excellent survey of the evolution of federal regulation of intrastate rates:[10]

The evolution of federal regulation of intrastate rates is properly to be traced by dividing the decisions construing the power of Congress over interstate commerce into five periods, each of which is more or less distinctly defined by reason of particular interpretations placed upon the commerce clause.

The first period dates from the adoption of the Constitution in 1789 to 1829. This period is noteworthy in that it evolved these two basic principles: First, that the actual regulation of interstate commerce by Congress excludes its regulation by the states. Second, that the power to regulate purely internal commerce rests exclusively with the states regardless of whether they actually exercise this power or not. This period will be called the Constructive Period.

The second period dates from 1829 to 1876, the year of the so-called Granger Cases. This period is noteworthy in that in addition to upholding the two basic principles of the first period, it gradually evolved, although not without great controversy, a third basic principle, namely, that in matters essentially national in their nature and requiring uniformity of regulation the exclusiveness of congressional power is not dependent upon actual exercise of that power, but arises from the very grant itself of the power; while in matters which, though affecting interstate commerce, are primarily of local interest, the power of the states to regulate is plenary in the absence of congressional action. This latter power is generally, though it would seem rather inaccurately, described as concurrent. The use of the word "concurrent" rather conveys the idea of simultaneous operation of the state and the federal power, whereas the one operates only when the other is not exercised. From the fact that the state power is dominated by, and must give way to, the federal power when exercised, it would seem perhaps more accurate to

[10] William C. Coleman, "The Evolution of Federal Regulation of Intrastate Rates: The Shreveport Rate Cases," *Harvard Law Review*, XXVIII, (November, 1914).

speak of the one power as *dominant* and of the other as *servient*. This second period will be called the States' Rights Period.

The third period, one of only ten years, dates from 1876 to 1886, the year of the decision in the case of Wabash, St. L. & P. Ry. Co. v. Illinois.[11] The decisions of this period are noteworthy in that they further extend the principle of so-called "concurrent" power to the point of saying that until Congress acts the states themselves may even regulate matters essentially national in their nature, namely, interstate rates, as well as those matters primarily of local interest. This period will be called the Extreme States' Rights Period.

The fourth period dates from 1886 down to, but not including, the so-called Minnesota Rate Cases[12] decided in 1913. During this period the decisions affirm the three principles enunciated in the first and second periods, and repudiate the Extreme States' Rights principle of the third period. This fourth period will be called the Federalistic Period.

The fifth and last period dates from the decision rendered in 1913 in the Minnesota Rate Cases to the present time, and therefore includes the decision in the Shreveport Rate Cases[13] rendered last June.[14] This period is noteworthy for the further and hitherto unknown restriction of state power. A principle never before announced is now evolved to the effect that state regulation of local rates is exclusive only until Congress acts, or, in other words, that the power of the state is servient not only in local matters affecting interstate commerce, but in the regulation of its own internal commerce as well. In short, it does not allow the corresponding usurpation of the federal government that was allowed to the states during the third or Extreme States' Rights Period, that is, regulation of intrastate rates until the states themselves regulate them, for of course that would be valueless; but it goes further and proclaims that

[11] 118 U. S. 557.

[12] 230 U. S. 352.

[13] 234 U. S. 342.

[14] That is, in June, 1914.

there may be regulation of intrastate rates by Congress to the exclusion of state regulation whenever Congress may see fit to act. In addition, with the Interstate Commerce Commission, an agent of Congress, be it noted, is primarily vested the determination of this fundamental constitutional question, namely, whether state action is to be excluded, or, in short, whether the commerce clause has been violated. This last period will be called the Period of Judicial Amendment, so radical is it in its extension of the doctrine of national supremacy.[15]

Federal Control Over Intrastate Rates

The Minnesota Rate Case and the Shreveport Case are the two important decisions from which the present status of the law may be derived. In these cases the extent of national control over local railway rates is judicially determined. In order that the problem involved in the conflict between state and federal authority in the regulation of railway rates and the existing attitude of the courts in the solution of the problem may be presented concretely, it will be useful to consider briefly the issues and results of these cases.

THE MINNESOTA RATE CASE

The main facts in the Minnesota Rate Case, decided in 1913, have been stated in an earlier chapter.[16] The stockholders of the Northern Pacific Railway Company, the Great Northern Railway Company, and the Minneapolis & St. Louis Railroad Company brought suit to restrain the enforcement of certain acts of the Minnesota legislature and of certain orders of the Minnesota Railroad and Warehouse Commission, issued in 1905 and

[15] *Harvard Law Review*, XXVIII, 36-38.

[16] See *supra*, pp. 107-110.

1906, whereby substantial reductions in freight and passenger rates were made. The chief grounds of complaint were: first, that the newly established rates were confiscatory, which claim, as we have seen, was partly upheld and partly denied by the Supreme Court; and second, that these rates were unlawfully imposed because they amounted to an unconstitutional interference with interstate commerce.

The basis of this denial of jurisdiction to the state of Minnesota and its commission was the claim, substantiated by a large mass of evidence, that these intrastate rates indirectly determined the level of interstate rates and thereby burdened interstate commerce. Although the acts of the legislature and the orders of the commission, by their terms, applied solely to the internal commerce of the state of Minnesota, the inevitable effect of the new rate adjustment was to impose an unlawful burden upon interstate commerce by creating unjust discriminations between localities in Minnesota and those in adjoining states. In fact, when the compulsory reduction in intrastate rates was put into force, the railroads involved reduced proportionately the interstate rates to nearby localities in adjoining states, in order to prevent discrimination against these localities and the loss of business that would doubtless ensue. The court's summary of part of the evidence will indicate its unanswerable strength from the purely economic standpoint:

> The state line of Minnesota on the east and west runs between cities which are in close proximity. Superior, Wis., and Duluth, Minn., are side by side at the extremity of Lake Superior. Opposite one another, on the western boundary of the state, lie Grand Forks, N. D., and East Grand Forks, Minn.; Fargo, N. D., and Moorehead, Minn.; and Wahpeton, N. D., and Breckenridge,

Minn. The cities in each pair ship and receive, to and from the same localities, the same kinds of freight. The railroad companies have always put each on a parity with the other in the matter of rates, and if there were a substantial difference it would cause serious injury to the commerce of the city having the higher rate. If the Northern Pacific Company failed to maintain as low rates on traffic in and out of Superior as on that to and from Duluth, its power to transact interstate business between Superior and points in Minnesota would be seriously impaired, and the value of its property in Superior would be depreciated.

The maximum class rates fixed by the order of September 6, 1906, were from 20 per cent to 25 per cent lower than those theretofore maintained by the Northern Pacific and Great Northern companies for transportation in Wisconsin, Minnesota, and North Dakota, whether such transportation was local to one of these states or was interstate between any two of them. When the Northern Pacific Company, pursuant to this order, installed the new intrastate rates, it reduced its interstate rates between Superior and points in Minnesota to an exact parity with its rates from Duluth. Reduction was also made in the rates between both Duluth and Superior and the above-mentioned points on the western boundary, so as to put the border cities in North Dakota on an equal basis with the neighboring cities in Minnesota. This reduction was substantial; and, had it not been made, the places adjoining the boundary, but outside the state, could not have competed with those within. Although the Northern Pacific Company thereby suffered a substantial loss in revenue from its interstate business, it had the choice of submitting to that loss or suffering substantial destruction of its interstate commerce to these border localities in articles covered by the orders.

In view of these and similar facts, the lower federal court declared the acts of the Minnesota legislature and the orders of the Minnesota commission to be unconstitutional, on the ground, first, that the action of

the state of Minnesota imposed a direct burden upon interstate commerce, and, second, that it conflicted with the provisions of the Act to Regulate Commerce. The Supreme Court overruled the decision of the lower court, denying both these contentions, and upheld the validity of the state action in ordering a reduction of rates. There was no direct regulation of interstate commerce, the Supreme Court held, because the new rates were specifically applicable only to the internal commerce of the state of Minnesota; and there was no conflict with the provisions of the Act to Regulate Commerce, because purely intrastate traffic was expressly excepted from the operation of the Act.[17]

The Supreme Court did recognize, however, that "new physical conditions had produced the anomaly of a double action of legislative powers upon business which is, and which should be, economically speaking, a unit and under the control of one body, the national government. They (the Justices of the Supreme Court) appreciated the gravity of the situation, and saw that some measure was unquestionably needed to relieve the business of transportation from the confusing and destructive dominance and jealousies of numerous state commissions, whereby effective authority on the part of the Interstate Commerce Commission was vitiated."[18] Accordingly, the court declared unanimously that state regulation of intra-state rates, if it did burden interstate commerce even indirectly, was not necessarily

[17] Provided, however, That the provisions of this Act shall not apply to the transportation of passengers or property, or to the receiving, delivering, storage, or handling of property wholly within one state and not shipped to or from a foreign country, from or to any state or territory as aforesaid."—Sec. 1.

[18] *Harvard Law Review*, XXVIII, 64.

supreme, state action being lawful and conclusive only in the absence of congressional action. The Minnesota rates were binding in this particular case because the federal government had taken no action with regard to them, either through Congress or through the Interstate Commerce Commission. In other words, the national power was declared to be dominant even over intrastate rates, in so far as they affect interstate commerce, provided Congress sees fit to exercise such power. While the validity of the acts and orders was upheld, it was explicitly suggested that the needed supremacy of federal authority could be lawfully secured through further legislation amending the Act to Regulate Commerce. Justice Hughes said:

> If the situation becomes such, by reason of the interblending of the interstate and intrastate operations of interstate carriers, that adequate regulation of their interstate rates cannot be maintained without imposing requirements with respect to their intrastate rates which substantially affect the former, it is for Congress to determine, within the limits of its constitutional authority over interstate commerce and its instruments, the measure of the regulation it should apply. It is the function of this court to interpret and apply the law already enacted, but not under the guise of construction to provide a more comprehensive scheme of regulation than Congress has decided upon. Nor, in the absence of federal action, may we deny effect to the laws of the state enacted within the field which it is entitled to occupy until its authority is limited through the exertion by Congress of its paramount constitutional power.[19]

The Minnesota Rate Case, then, paved the way for national supremacy in the conflict between state and federal authority, by suggesting the expedient of further legislation, declared to be constitutionally possible under

[19] 230 U. S. 432, 433.

the existing distribution of power between the nation and the states. In the Shreveport Case this end was accomplished without additional legislation.

THE SHREVEPORT CASE

Complaint was brought before the Interstate Commerce Commission in 1911, through the Railroad Commission of Louisiana, against the Texas & Pacific Railway Company, the Houston East & West Texas Railway Company, and other carriers, on the ground that these railways made rates from Dallas, Houston, and other Texas points, to places in eastern Texas, which were unduly low as compared with the rates from Shreveport, La., to these same points in Texas, and were therefore discriminatory with reference to Shreveport.

Shreveport is 231 miles from Houston and 189 miles from Dallas, in Texas, being about 40 miles east of the Texas boundary. All three places are competitors for the business of intermediate localities in eastern Texas. The rates eastward from Houston and Dallas were substantially lower than the rates westward from Shreveport, resulting in serious commercial disadvantage to the interests of Shreveport. These rates on intrastate traffic in Texas had been fixed by the Texas Railroad Commission with the avowed purpose of securing special advantages for its state traffic at the expense of neighboring localities.

The Interstate Commerce Commission, in its decision,[20] established class rates from Shreveport to certain places in Texas substantially on the same level as the intrastate Texas rates, with which order as to in-

[20] Meredith et al., constituting the Railroad Commission of Louisiana v. St. L. S. W. Ry. Co. et al., 23 I. C. C. Rep. 31.

terstate rates the railways concerned readily complied; and it declared the commodity rates which the Texas Railroad Commission had ordered from Houston and Dallas to certain Texas points, which were substantially lower than those prevailing from Shreveport to the same localities, to constitute unjust discrimination against Shreveport. The railways refused to comply with this order as to the commodity rates on the ground that it was beyond the scope of the power of the Interstate Commerce Commission to question the validity of intrastate rates that had been fixed by a state railroad commission. On appeal to the Commerce Court, the order of the Interstate Commerce Commission was upheld.[21] The case was then appealed to the Supreme Court of the United States, and the order of the Commission was attacked: first, on the ground that it was beyond the scope of federal authority to regulate intrastate rates; and, second, on the ground that the Interstate Commerce Commission was not vested with such authority, even if Congress possessed the power to regulate intrastate rates which indirectly burden interstate commerce.

The Supreme Court denied the validity of both of these contentions, upholding the order of the Interstate Commerce Commission and the decision of the Commerce Court. That the federal government possessed the power of control over intrastate rates which indirectly regulate interstate commerce, had been amply established in the Minnesota Rate Case. The important issue in the Shreveport Case was whether this authority had been exercised by Congress—in other words, whether

[21] T. & P. Ry. Co. v. U. S. (I. C. C. et al., Interveners), 205 Fed. 380 (1913); E. & W. Texas Ry. Co. et al. v. U. S. (I. C. C. et al., Interveners), 205 Fed. 391 (1913).

the Interstate Commerce Commission was clothed with sufficient power to overrule the order of a state railroad commission prescribing maximum freight rates on intrastate traffic.

The Supreme Court found that such power did reside in the Interstate Commerce Commission, in spite of the proviso in the first section of the Act to Regulate Commerce expressly excepting intrastate traffic from the operation of the law. The Commission derived this authority from its power to prevent discrimination between localities, in accordance with the provision of the third section of the Act. That there was discrimination against Shreveport, as there had been against localities adjoining the east and west boundaries of Minnesota, cannot be questioned. That this discrimination resulted from the lawful adjustment of intrastate rates was held to be immaterial. The power of Congress over interstate commerce is plenary and supreme. Congress vested in the Interstate Commerce Commission full authority to prevent unjust discrimination between localities. This authority may be exercised by the Commission whether the discriminations result from the relationship between intrastate rates, prescribed by state commissions, and interstate rates, established by federal order, or through the voluntary practices of railways engaged entirely in interstate commerce. To use the words of the Court:

> We are not unmindful of the gravity of the question that is presented when state and federal views conflict. But it was recognized at the beginning that the nation could not prosper if interstate and foreign trade were governed by many masters, and, where the interests of the freedom of interstate commerce are involved, the judgment of Congress and of the agencies it lawfully establishes must control.

The Present Status

Under the compelling stress of economic conditions, after a notable legal struggle, the dominance of federal control in railway regulation seems to be clearly established. Justice Hughes, in the Shreveport Case, has tersely indicated the broad scope of the national power in these words:

> By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control.

It is not unlikely, therefore, that the chief future usefulness of the state railroad and public service commissions will be found in connection with the so-called local or municipal utilities, which are subject to no control save that of the states and of the municipalities. In these local utilities, too, the need of centralization is becoming increasingly felt, and state commissions are tending to dominate, if not to replace entirely, the activities of municipal boards. In railway regulation the prevailingly national character of American commerce and industry obviously necessitates a single unified control. By recognizing the supremacy of the federal government, acting through the Interstate Commerce Commission, the courts are gradually harmonizing legal rules and economic needs in railway regulation.

TEST QUESTIONS

1. Explain the limitations upon state and national action imposed by the Fifth and Fourteenth Amendments to the federal Constitution.
2. Distinguish between delegated and reserved powers.
3. Under what provision of the Constitution was the Interstate Commerce Commission established by Congress?
4. Distinguish between intrastate and interstate commerce, and show the close relationship existing between them.
5. Explain the basis of the conflict between state and federal authority in the regulation of railway rates.
6. Trace the varying judicial interpretations of the commerce clause, and show their bearing upon the problem of railway regulation.
7. State concisely the issues and results in the Minnesota Rate Case and in the Shreveport Case. What is the important difference between the two cases?
8. Explain carefully the present extent of federal control over intrastate rates.
9. Under what section of the Act to Regulate Commerce is the federal authority over intrastate rates exercised?

CHAPTER X

FEDERAL REGULATION [1]

The Causes of Federal Regulation

The underlying causes of federal regulation may be found in the general trend of American railway development which has been described in some detail in one of the early chapters of this text. More specifically, the rapid growth of railway mileage and the development of interstate traffic created the necessity of regulating the railway service on a national centralized basis.

Hardly was the Granger Movement well under way when suggestions for national legislation began to be heard. Like the Granger Movement itself these suggestions sprang from the belief that railway rates were excessively high. Some agitation followed, especially in the middle west, where a need was felt for cheaper rates to the Atlantic seaboard, and an investigation by a committee of the United States Senate was the result. The Windom Committee submitted its report in 1874.[2] While this report contained much valuable material on the

1 The important policies and principles employed by the Interstate Commerce Commission in the regulation of railways have already been discussed in connection with the various problems treated in the preceding chapters. Moreover, a distinct text in the course in Interstate Commerce and Railway Traffic is devoted to a consideration, section by section, of the Act to Regulate Commerce and the other acts amendatory thereof and supplementary thereto. In this place, therefore, there is presented, in outline, a general survey of federal legislation, with a brief indication of its purposes and effects.

2 43rd Congress, 1st Session, Senate Report 307.

American railway situation at that time, the conclusions and recommendations of the committee gave evidence of what would now be considered immature ideas as to the root of the railway problem. The report proceeded on the hypothesis that permanent improvement in railway conditions could be secured only through the stimulation of competition, and hence the committee recommended the further development of waterways and the construction of additional lines between the middle west and the Atlantic. No action was taken by Congress, and the natural course of events served to silence the complaints against the extortionate character of railway rates.[3]

The present system of federal regulation was the direct outcome of the report of the Cullom Committee which was submitted to the United States Senate in 1886.[4] The crying evil at this time was the wide prevalence of discriminatory practices and not the unreasonableness of railway rates. The committee declared that "the paramount evil chargeable against the operation of the transportation systems of the United States, as now conducted, is unjust discrimination between persons, places, commodities, or particular descriptions of traffic." The existence of personal discrimination, as revealed in the then current Standard Oil Company litigation, was especially instrumental in arousing public sentiment to the need of federal action.

In the same year, too, came the settlement of the Wabash Case,[5] in which the Supreme Court held that the

3 "The rate wars of the seventies; a revival of general prosperity in 1879; and great mechanical improvements and economies in operation, had brought about the desired decline of freight rates."—W. Z. Ripley, *Railroads: Rates and Regulation*, 444.

4 49th Congress, 1st Session, Senate Report 46.

5 W. St. L. & P. Ry. Co. v. Illinois, 118 U. S. 557.

jurisdiction of each state in the regulation of railways must be confined to intrastate traffic and that interstate commerce must remain unregulated until Congress should see fit to act. The question before the court in this case was the validity of an Illinois statute which provided that if any railroad company should charge or receive the same or a greater sum for the transportation of passengers or freight of the same class within the state for any distance than it did for a longer distance in the same direction, the practice should be considered unlawful and the company should be liable to pay a penalty for unjust discrimination. The carrier made such discrimination in the transportation of goods from Peoria and Gilman, in Illinois, to New York, by charging a higher rate for the same class of goods carried from Gilman than from Peoria, although Gilman was eighty-six miles nearer to New York city than Peoria, "this difference being in the length of the lines in the State of Illinois." The court, in declaring the statute invalid as a regulation of interstate commerce, said:

> We must, therefore, hold that it is not, and never has been, the deliberate opinion of the majority of this court that a statute of a state which attempts to regulate the fares and charges by railroad companies within its limits, for a transportation which constitutes a part of commerce among the states, is a valid law.

The Wabash case is said to have put "the match to the long train of influences" making for federal action. Congress approached the problem of railway regulation with greater seriousness than it had done in 1874, and in 1887 the Act to Regulate Commerce, the basis and main structure of our system of governmental control, was enacted into law.

Its General Character

We shall see that the federal laws upon which our system of regulation is based embrace a great variety of rules and principles and provide a complex machinery for their enforcement. The main purposes of all the legislation, however, may be reduced to two. It aims *to establish reasonable rates* and *to prevent discriminatory practices.* All the provisions of the various acts are intended to promote one or another of these purposes.

In addition to the sections bearing directly upon rates and discrimination, the provisions consist of specific substantive rules, such as those dealing with rate publicity or accounting practices, compliance with which tends to make more certain the exaction of reasonable rates and the elimination of preferential treatment; or they consist of adjective rules indicating the practice and procedure to be followed by the Commission and the courts in the enforcement of the law.

The system of regulation thus established aims to achieve its purposes through administrative control. It recognizes the inadequacy of mere judicial enforcement of the common law duties of common carriers as a protection for the public interest. Direct legislative regulation, too, is conceived as spasmodic and ineffective. Railway control must be entrusted to experts and must be continuous. Its purpose is to establish a proper relationship between railway corporations and the general public and not merely to afford adequate remedies to injured passengers or shippers as individuals. The essence of public control, then, consists in the provision of just and fair standards of conduct for the future, and this can be accomplished only through administrative commissions clothed with ample authority to make spe-

cific orders as to rates and service and to enforce prompt obedience to these orders.

It is to be noted, however, that even a system of administrative regulation does not dispense entirely with legislative and judicial activity. Administrative commissions are limited to the exercise of powers expressly conferred upon them or naturally incidental to the performance of their public duties. The source of commission authority, therefore, resides in the legislature, and the extent of that authority is dependent upon legislative action. Moreover, legislatures frequently pass direct laws for the regulation of railways in addition to the statutes by virtue of which the commissions are created and the general system of control is established. Thus, the states have passed numerous maximum rate laws and many regulations covering details of train operation, car supply, character of equipment and station buildings, hours of labor, and conditions of employment, and setting up standards of safety. The federal government, too, through the direct action of Congress, has enacted special statutes dealing with safety appliances, reports of accidents, hours of service, transportation of explosives, boiler inspection, block signals, and the like.

The courts also play an important part in our systems of administrative control, state and national, because they are called upon to determine the validity of the laws under which commissions assume to act and to restrain these commissions within the scope of the authority lawfully entrusted to them. Within the limitations imposed by law, however, our commissions tend to be supreme. The real task of railway regulation is now clearly vested in the Interstate Commerce Commission and in the state railway and public service commissions.

The details of state regulation were described and

examined in a preceding chapter. We shall now trace, in brief outline, the important details of our system of federal regulation as it has developed since the enactment of the Act to Regulate Commerce in 1887.

The Act to Regulate Commerce

Organization and Jurisdiction of Commission

The Interstate Commerce Commission, as originally created, was composed of five members, appointed by the President, for regular terms of six years, at a salary of $7,500 for each of the commissioners, with a provision for the employment of necessary assistance. The principal office of the Commission was to be located in Washington, though sessions were authorized in any part of the United States. The changes in the organization of the Commission introduced by the Hepburn amendments of 1906 may also be here noted. The membership of the Commission was increased to seven; the tenure of office was lengthened to seven years; and the salaries were raised to $10,000.[6] On this basis the Interstate Commerce Commission is now organized.

In defining the jurisdiction of the Commission the Act was made to apply to common carriers "engaged in the transportation of persons or property wholly by railroad, or partly by railroad and partly by water, when both are used under a common control, management, or arrangement."[7] Independent water lines were left outside the scope of the Act, and no specific mention was made of such carriers as express companies, sleeping car

[6] Act to Regulate Commerce, amended in 1906, secs 11, 18, and 19.

[7] This provision of the original Act to Regulate Commerce, together with certain provisions of the Panama Canal Act of August 24, 1912, constitute

companies, and pipe lines. It was provided that the term *railroad* should include bridges and ferries. The *transportation* to be covered was defined so as to include foreign and interstate traffic, and the carriage of persons or goods between territories, or states and territories, and the District of Columbia. Intraterritorial commerce was not included within the scope of the Act, and intrastate traffic was specifically excluded.[8] By the Hepburn Amendments of 1906 the Act was made to apply to intraterritorial traffic.

RATE REASONABLENESS

The Act laid down the general principle, declaratory of the common law and found in practically all state statutes then in effect, that all rates and charges must be just and reasonable and that every unjust and unreasonable charge is prohibited and declared to be unlawful. This enunciation, coupled with the provision that the Commission is authorized to execute and enforce the provisions of the Act, constituted all the direct rate-making power vested in the Interstate Commerce Commission.[9]

The anti-pooling section was doubtless incorporated in the Act as an indirect means of preventing excessive charges. It reflects the confused ideas, once largely prev-

the basis of the Commission's authority over rail and water transportation along the Great Lakes and across the Panama Canal. For a consideration of the meaning and significance of the phrase "common control, management, or arrangement," as interpreted by the Commission and the courts, see H. C. Lust, *The Act to Regulate Commerce and Supplemental Acts*, 9-13; for an analysis and discussion of the provisions of the Panama Canal Act, in so far as they affect the jurisdiction of the Interstate Commerce Commission, see *Ibid.*, 65-67, 77-78.

[8] Sec. 1.

[9] Secs. 1, 12.

alent and still current to some extent, on the efficacy of competition as a solution of the railroad problem. It provides that railways are forbidden to enter into "any contract, agreement, or combination with any other common carrier or carriers for the pooling of freights of different and competing railroads, or to divide between them the aggregate or net proceeds or earnings of such railroads or any portion thereof." [10] This anti-pooling clause was one of the most earnestly debated provisions of the Act, and its repeal is now very generally urged.

DISCRIMINATORY PRACTICES

Equal charges were required for like and contemporaneous services rendered to different persons under substantially similar circumstances and conditions; and the giving of any undue or unreasonable preference or advantage to any person, concern, locality, or kind of traffic was prohibited. Each railway was also required to interchange traffic with connecting lines without discriminating between them in the adjustment of rates.

The long-and-short-haul clause made it unlawful for the railways "to charge or receive any greater compensation in the aggregate for the transportation of passengers or of like kind of property, under substantially similar circumstances and conditions, for a shorter than for a longer distance over the same line, in the same direction, the shorter being included within the longer distance." It was provided, however, in this fourth section, that the Commission might in its discretion relieve any carrier of the operation of the clause to such extent as it might deem advisable. The carriage of freight from the point of shipment to the point of destination was to

[10] Sec. 5.

be regarded as one haul, unless stoppage was made in good faith for some necessary purpose. This provision was intended to prevent interruptions in the continuous carriage of freight, such as might be resorted to for the purpose of making a through haul appear to be two or more local hauls. Finally certain classes of persons and of traffic were enumerated to which reduced rates or free transportation might be granted.[11]

Certain provisions of the Act were intended to aid, indirectly, in accomplishing its main purposes of establishing reasonable rates and preventing discriminatory practices. Among these are the provisions dealing with rate publicity and the general investigating powers of the Commission.

PUBLICITY OF RATES

Each carrier was to print and keep open to public inspection schedules of its rates and fares, these schedules to be posted in two conspicuous places in freight and passenger depots, "in such form that they shall be accessible to the public and can be conveniently inspected." Ten days' public notice of an advance in rates was required, and, by an amendment passed in 1889,[12] three days' notice of a reduction. Railways were compelled to file copies of their published schedules with the Commission, and were forbidden to charge or receive a greater or less compensation for any service than that specified in these schedules.

Joint tariffs were also to be filed with the Commission, which was authorized to require such publication of them

[11] Secs. 2, 3, 4, 7, and 22.

[12] Certain minor changes in the original Act to Regulate Commerce were made in 1889. These are treated here in connection with the original Act, and not separately, as are the more important amendments.

as it deemed wise. The amendment of 1889 provided for ten days' notice of an advance and three days' notice of a reduction in joint rates; it forbade carriers to depart from them; and it authorized the Commission to prescribe the form in which all schedules should be prepared and arranged for public inspection.[13]

INVESTIGATING POWERS OF COMMISSION

As an investigating body the Commission was vested with power to inquire into the management of the business of all common carriers subject to the Act, and to require by subpoena the presence and testimony of witnesses and the production of all books, papers, tariffs, contracts, agreements, and documents relating to the matter under investigation. In case of disobedience to a subpoena, the Commission was authorized to appeal to a federal court, which was empowered, though not required, to order compliance with it. Evidence required to be given in any proceeding before the Commission could not be used against the witness in the trial of any criminal suit arising out of this proceeding.[14] The Commission was empowered to institute any inquiry on its own motion in any part of the country. Furthermore,

[13] Sec. 6.

[14] On February 11, 1893, a Compulsory Testimony Act was passed which provided that in any cause or proceeding, criminal or otherwise, based upon or growing out of alleged violations of the Act to Regulate Commerce, no person shall be excused from testifying on the ground that such testimony may tend to criminate him, but no person so testifying shall be prosecuted for, or on account of, any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in any such case or proceeding. On June 30, 1906, a Supplementary Act was passed, providing that immunity shall extend only to a natural person who, in obedience to a subpoena, gives testimony or produces documentary or other evidence under oath.

the Commission was authorized to require annual reports from all carriers, determining the form of these reports, and to establish a uniform system of accounts, prescribing the manner in which such accounts shall be kept.[15]

The remainder of the Act dealt with questions of enforcement, indicating the remedies available for the injured shipper and the penalties imposed upon the offending carrier, and prescribing the practice and procedure to be followed upon complaint and in the execution of the orders of the Commission.

REMEDIES AND PENALTIES

It was provided that damage suits might be brought by persons injured by violations of the Act as private remedies, and criminal penalties were prescribed as an aid to the public enforcement of the law. Any common carrier, or whenever such common carrier was a corporation, any director or officer thereof, or any receiver, trustee, lessee, agent, or person acting for or employed by such corporation, who wilfully violated or ignored the provisions of the Act, or who aided or abetted such deed, was to be punished by a fine of not more than five thousand dollars for each offense. By the amendment of 1889, persons guilty of the special violation involved in discrimination were to be fined as just indicated, or imprisoned for a term not exceeding two years, or subjected to both penalties at the discretion of the court.[16]

PROCEDURE UPON COMPLAINT

Persons, firms, corporations, business associations, and the like, as well as local governments and state railroad

[15] Secs. 12, 13, 19, and 20.

[16] Secs. 8, 9, 10, and 23.

commissions, were privileged to bring complaints against carriers ignoring or violating the Act. If the carriers did not make reparation for the alleged injury, or if there appeared reasonable ground for an investigation, the Commission was authorized to investigate the complaint in such manner and by such means as it should deem proper; and it was expressly provided that no complaint should be dismissed because of the absence of direct damage to the complainant.

Proceedings before the Commission were to be conducted in such manner as would "best conduce to the proper dispatch of business and to the ends of justice." The Commission was authorized to establish general rules for the regulation of its proceedings, including forms of notice and the service thereof, which were to "conform as nearly as may be to those in use in the courts of the United States." Upon completing the investigation of any complaint, it was the duty of the Commission to prepare a written report, a copy of which was to be furnished to each party involved. The findings of fact in such reports were in all judicial proceedings to "be deemed prima facie evidence as to each and every fact found." If the investigation disclosed any violation of law, the Commission was to serve, with its report, a notice to the offending carrier to desist from such violation, and was empowered to require the carrier to make reparation to any person or persons injured by its wrongful act.[17]

ENFORCEMENT

The proceedings for enforcing the orders thus issued by the Commission, in case of disobedience by the rail-

[17] Secs. 13, 14, 15, and 17.

ways, were as follows.[18] If the nature of the case was not such as to require a trial by jury under the seventh amendment to the federal Constitution, the Commission or any person interested in its decision was authorized to apply to the proper federal circuit court for an enforcing order. The court was to "hear and determine the matter speedily as a court of equity, and without the formal pleadings and proceedings applicable to ordinary suits in equity, but in such manner as to do justice in the premises." If it appeared that a *lawful order* of the Commission had been violated, it was to be in the power of the court to issue a writ of injunction or other proper process enjoining obedience to the order. Punishment for contempt of court arising out of the violation of such an injunction was to consist of a fine of five hundred dollars per day for each person participating in the transgression. If the controversy was such as to demand a trial by jury, any interested person was authorized to apply to the proper circuit court, which was to summon a jury and hear the proceedings. If the parties involved agreed to waive a jury, the federal judge was himself to try the issues and render judgment.[19] Appeal lay from the lower federal courts to the Supreme Court of the United States.[20]

[18] As amended in 1889.

[19] Sec. 16.

[20] On February 11, 1903, the Expediting Act was passed. It provided that in any equity suit in a circuit court, arising under the Act to Regulate Commerce, the Anti-Trust Act, or any other act "having a like purpose," the Attorney-General, if the United States is complainant, may file a certificate that in his opinion the case is of "general public importance." Thereupon the case must "be given precedence over others and in every way expedited, and be assigned for hearing at the earliest practicable day." Appeals lie only to the Supreme Court and must be taken within sixty days.

The Elkins Act

Such was the Act upon the basis of which the federal system of railway control was established and upon which in the main it still rests. The original Act has, however, been considerably modified by subsequent legislation. A few minor amendments, to which reference has already been made in several connections, were passed in 1889. The first important amendments to the system of federal regulation as a whole were not enacted till 1906.

In the meantime, in 1903, the Elkins Act was passed. It was concerned almost exclusively with the problem of discrimination. It was urged by the public very largely as an anti-trust measure, on the ground that industrial monopoly was being fostered and maintained through the instrumentality of railway discriminations and would be seriously weakened if such practices were effectually prevented. The railways welcomed the measure, and lent their aid to its enactment, as a means of conserving their shrinking revenues. The Elkins Act strengthened the law against discrimination in several important respects.

It provided that the act of any officer, agent, or employee of a railway corporation, within the scope of his employment, was to be regarded as the act of the corporation, and that for any violation of the Act to Regulate Commerce both the corporation and the person responsible for the deed were to be subject to the penalties prescribed by law. Imprisonment was abolished as a penalty, on the ground that the necessary evidence for the enforcement of the provisions against discrimination could be more easily secured in the absence of so stringent a punishment.

Departure from the published schedules was made the sole test of discrimination. The wilful failure of a car-

rier to file and publish its schedules as required by law was made punishable by a fine of not less than one thousand and not more than twenty thousand dollars; and any departure or offer to depart from the rates and charges stated in the schedules properly filed was declared to be unlawful and likewise subjected the carrier to these penalties. Moreover, the shipper receiving preferential treatment as well as the carrier granting it was to be regarded as guilty of unlawful conduct. It was declared to be unlawful for any person or corporation to solicit, accept, or receive, as well as to offer, grant, or give, any rebate, concession, or discrimination, whereby property shall by any device whatever be transported at a less rate than that named in the tariffs published and filed, or whereby any other advantage is given or discrimination practiced.

In brief, then, the Elkins Act made railway corporations as well as their officers and agents liable for discriminatory practices; it abolished the penalty of imprisonment; it declared the published tariffs to be the standards of fair rates and provided that departure from these published tariffs was to constitute the conclusive test of discrimination; and it made the shipper as well as the carrier subject to the penalties imposed for a violation of the provisions against discriminatory practices.

The Hepburn Act

The first important changes in the Act to Regulate Commerce were adopted on June 29, 1906, by the enactment of the Hepburn amendments. The Hepburn Act aimed to strengthen the entire system of federal control, both by supplementing the provisions of the original

Act, in those respects in which changed conditions made necessary the extension of federal authority, and by re-establishing the effectiveness of those provisions which had been weakened or nullified through judicial interpretation. These amendments mark the rejuvenation of the Interstate Commerce Commission, and from 1906 dates the permanent establishment of comprehensive and thorough-going administrative control of railways in the United States. We will proceed to a brief analysis of the main provisions of the Hepburn Act and a consideration of their purposes.

EXTENSION OF THE COMMISSION'S JURISDICTION

The scope of the Act to Regulate Commerce and the jurisdiction of the Interstate Commerce Commission were extended to include express companies, sleeping-car companies, and pipe-lines used in the transportation of oil or any other commodity except water or gas. The term "railroad" was declared to embrace switches, spurs, tracks, terminal facilities of every kind, freight depots, yards, and grounds. The term "transportation" was defined so as to include cars and other vehicles, all instrumentalities and facilities of shipment or carriage irrespective of ownership or contract, and "all services in connection with the receipt, delivery, elevation, and transfer in transit, ventilation, refrigeration or icing, storage, and handling of property transported." Furthermore, it was made the duty of all carriers subject to the Act to provide such transportation facilities upon reasonable request and to make them available at just and reasonable rates.

GRANTS OF AUTHORITY OVER DISCRIMINATORY PRACTICES

In spite of the substantial strengthening of the law against discrimination which resulted from the enforcement of the Elkins Act of 1903, the granting and accepting of rebates and the resort to other discriminatory practices had not entirely ceased when the Senate Committee was investigating the railroad situation in 1906 and the Hepburn amendments were under consideration. Accordingly, additional grants of power were vested in the Interstate Commerce Commission calculated to increase in effectiveness its authority over discriminatory practices. This further strengthening of the law against discrimination was secured indirectly, in large measure, through the extension of the Commission's jurisdiction, indicated above, as well as through the enactment of new legislative provisions directly aimed at the elimination of unjust preferential treatment by the railways.

The extended scope of the Act to Regulate Commerce, resulting from the express inclusion of pipe lines and sleeping-car companies within the Commission's jurisdiction and from the more precise and comprehensive definition of the terms "railroad" and "transportation," enabled the Interstate Commerce Commission to reach more successfully the Standard Oil monopoly which had been built up to such a large extent through the instrumentality of railway rebates and by the aid of its pipe lines, and it helped the Commission to prevent more effectively certain of the modern forms of railway discrimination, particularly those practiced through the operation of private car lines and the so-called "industrial railroads."

Private-car lines came under the control of the Commission because of the specific mention of sleeping-car

companies and the inclusion, in the jurisdictional section of the Act, of all instrumentalities and facilities of shipment or carriage, irrespective of ownership or contract. Moreover, the Commission was given authority over all services performed by private-car companies; and the separate publication of terminal, storage, and icing charges, as well as those for any other privileges or facilities, was expressly provided for.

The industrial railroads or tap lines came under the control of the Commission because the Act to Regulate Commerce was made to apply to switches, spurs, tracks, and terminal facilities of every kind. The Commission was empowered to establish through routes and maximum joint rates, whenever the carriers neglect to do so, and to fix reasonable switching charges and make proper apportionment of through rates. The authority of the Commission to establish reasonable maximum charges to be paid by carriers to any shipper who directly or indirectly renders any service in connection with the transportation of his goods was likewise aimed, in part at least, at the special treatment secured by favored shippers through the industrial railroads.

Moreover, it was expressly made the duty of carriers to construct switch connections under certain conditions, and authority was vested in the Commission to order such switch connections. The conditions under which this duty becomes operative were set forth substantially as follows: that upon application of any lateral branch line of railroad, or of any shipper tendering interstate traffic for transportation, common carriers must construct, maintain, and operate upon reasonable terms a switch connection with any such lateral branch line of railroad, or private side track which may be constructed to connect with its railroad, where such connection is

reasonably practicable and can be put in with safety and will furnish sufficient business to justify the construction and maintenance of the same, and they must furnish cars for the movement of such traffic to the best of their ability without discrimination in favor of, or against, any such shipper.

The ownership of industrial enterprises by railway corporations and the vital concern of such railways in the commercial success of these enterprises have resulted in recent years in another indirect form of railway discrimination, for the successful elimination of which, existing law, in 1906, was inadequate. The nature of the abuse has been concisely described by Professor Dixon as follows:

> Another serious and elusive form of discrimination has been practiced with special success by the coal roads. By virtue of being owners of coal mines and transporters of their own products, as well as that of independent operators, they have been enabled so to manipulate their books that it has been impossible for either the Commission or the courts to decide whether the advantage which they enjoyed over independent shippers should be regarded as a discrimination granted to themselves as carriers or a loss suffered by them as producers. The extraordinary situation revealed in the affairs of the Pennsylvania Railroad by the investigation of the Interstate Commerce Commission while the rate bill was under discussion in the Senate, combined with the sentiment fostered by long-continued troubles in the coal fields, resulted in the incorporation of a radical clause. . . .[21]

This situation led to the enactment of the so-called "commodities clause" of the Hepburn Act, which sought to separate the business of transportation from ordinary

[21] Frank H. Dixon, "The Interstate Commerce Act as Amended in 1906," *Quarterly Journal of Economics*, 1906, 22-51.

commercial and industrial enterprise. By the terms of this clause it was provided that after May 1, 1908, it would be unlawful for any railroad company to transport in interstate commerce any commodity, other than timber or the manufactured products thereof, mined, manufactured, or produced by it or under its authority, or which it may own in whole or in part, or in which it may have any interest direct or indirect, except such articles as are necessary and intended for its use as a common carrier.

Under this commodities clause persistent and strenuous action has been taken by the federal government to bring about a relinquishment of their coal holdings by the so-called "coal roads," especially in the anthracite coal regions of Pennsylvania. Owing to the intricacies of corporate organization and the complexities of intercorporate relationships, complete success in bringing about a distinct separation between these railways as carriers and as shippers has not yet been attained, although more than seven years have now elapsed since the date fixed from which the commodities clause was to operate.[22]

The remaining provisions of the Hepburn Act bearing directly upon the problem of discrimination can be very briefly summarized. The penalty of imprisonment (for a term not exceeding two years), which had been removed by the Elkins Act, was now restored, and was specifically made applicable to shippers as well as to agents or officers of carriers guilty of discrimination. Furthermore, the

[22] An excellent discussion of the entire problem will be found in Eliot Jones, *The Anthracite Coal Combination in the United States.* A summary treatment will be found in W. Z. Ripley, *Railroads: Finance and Organization,* 534-548. Ripley, *Railroads: Rates and Regulation,* 552-556, contains a brief discussion of the judicial interpretation of the commodities clause.

federal government was given authority to collect from any shipper, in a civil suit, three times the amount of all rebates received by him in any form or through any device for a period of six years prior to the institution of the action. Both of these provisions, it is believed, strengthened the arm of the government. Finally, subject to specified exceptions, common carriers were expressly forbidden to issue or give any interstate free ticket, free pass, or free transportation for passengers; and all persons, other than those excepted, were forbidden to use the same. The penalty for violation of this provision, applicable alike to the carrier giving the free transportation and the person making use of it, was declared to be not less than one hundred dollars nor more than two thousand dollars for each offense.[23]

EXPRESS DELEGATION OF RATE-MAKING POWER

The most important and significant provisions of the Hepburn Act are those dealing with the rate-making power of the Commission. By the Maximum Freight Rate Decision, rendered in 1897, the Interstate Commerce Commission had been shorn of its power to prescribe rates.[24] Its authority was decreed to be limited to the

[23] An elaborate list of exceptions is enumerated in the Act. It has been summarized as follows: "Two general classes of exceptions are made to the application of the statute. The first class includes railroad employees and their families, officials, railroad surgeons and attorneys, and employees of agencies associated with the railroad business, such as those of the sleeping-car, express, telegraph, post office, customs, and immigration service, care-takers of live-stock, and newsboys and baggage men on trains. The second class comprises the poor and unfortunate classes and those engaged in religious and charitable work."—Frank H. Dixon, "The Interstate Commerce Act as Amended in 1906," *Quarterly Journal of Economics*, 1906, 22-51.

[24] See *supra*, pp. 91-93.

right of declaring past rates unreasonable and unlawful. The authority of fixing rates for the future, which it had exercised for a decade, from 1887 to 1897, was denied to the Commission, thereby completely nullifying its rate-making power and rendering its control over railway rates purely nominal. The chief purpose of the Act of 1906 was to remedy this situation, and the rate section of the statute constitutes the great distinctive feature of the legislation.

The rate-making power was expressly delegated, or redelegated, to the Interstate Commerce Commission by a clause providing that the Commission is empowered, and it is made its duty, whenever, after full hearing on complaint, it is of the opinion that any rates or charges (or any regulations or practices affecting rates or charges) are unjust, unreasonable, unjustly discriminatory, or otherwise in violation of the Act to Regulate Commerce, to determine and prescribe what will be the just and reasonable rates, charges, regulations, and practices to be thereafter observed and followed. The rates and fares so prescribed are to be enforced as the maximum to be charged by the railways against whom the orders are issued. These orders are to go into effect in not less than thirty days and are to remain in effect for two years or less, as determined by the Commission, unless suspended, modified, or set aside by the Commission or by a court of competent jurisdiction.

As already noted in connection with the provisions on discrimination, the power to establish through routes and joint rates, and to prescribe the division or apportionment of such rates, was likewise vested in the Commission, as well as the authority to fix the compensation to be paid by a carrier to shippers who render any service or

furnish any instrumentality used in connection with the transportation of their goods. Wilful violation of an order of the Commission prescribing rates or charges was made punishable by a fine of five thousand dollars for each offense; every distinct violation, and in case of a continuing violation each day thereof, being declared a separate offense.[25]

STRICT SUPERVISION OF ACCOUNTING PRACTICES

The provisions of the Hepburn Act conferring upon the Commission the power to exercise strict supervision of railway accounting practices have served to strengthen its authority over rates and discrimination and have provided a fundamental basis for the enforcement of the entire system of federal control.

In addition to the general power to prescribe a uniform system of railway accounts vested in the Commission by the original Act, the Interstate Commerce Commission was authorized to prescribe the forms of any and all accounts, records, and memoranda kept by common carriers, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of money. Moreover, it was made unlawful for such carriers to keep any other accounts or records than those prescribed or approved by the Commission, or to alter, mutilate, or destroy any accounts or records, or to make any false entry therein.

As a means of executing these provisions the Com-

[25] In addition to the above provisions as to rates, the Act required thirty days' public notice and thirty days' notice to the Commission, of all advances and reductions in rates. This requirement was also made applicable to joint rates. The Commission was given authority to modify or suspend these publicity provisions upon adequate cause being shown.

mission was given the right to have access at all times to the accounts and records of the carriers and to employ special agents or examiners who possess the authority, under the order of the Commission, to inspect all such accounts and records. As an aid toward the enforcement of these accounting practices, heavy penalties were imposed in case of violation. Any person wilfully making false entries, or destroying, mutilating, or altering any record, or keeping any other accounts or records than those approved by the Commission was made liable to a fine of from one thousand to five thousand dollars, or imprisonment of from one to three years, or both. Any examiner who divulges information gained in his inspection except in so far as he is directed to do so by the Commission or by a court was also made liable to a fine of not more than five thousand dollars, or imprisonment for a term not exceeding two years, or both.

CHANGES IN PROCEDURE AND ENFORCEMENT

Under the original Act to Regulate Commerce, as applied in practice, there were serious defects in the procedure of the Commission and in the enforcement of the Commission's orders by the courts. In the first place, there were intolerable delays in the settlement of railway rate disputes, the real termination of all controversies being postponed till their final adjudication by the Supreme Court of the United States, which not infrequently caused a delay of a number of years. Little relief for this situation was secured through the Expediting Act of 1903 [26] because of the readiness of the federal courts to give independent consideration to the facts upon

[26] See *supra*, p. 200.

which the orders of the Interstate Commerce Commission were based, often admitting new evidence that had been purposely withheld by the defendant railways in the original hearings before the Commission. Furthermore, the courts exercised a broad power of review, which resulted in the substitution of judicial discretion, in large matters of economic policy, for the more expert judgment of the Interstate Commerce Commission.

These circumstances diminished the power and weakened the influence of the Commission. The administrative body that had apparently been created for the purpose of developing and enforcing the federal system of railway regulation came to occupy a position distinctly subordinate to that of the courts in the performance of these functions; and all investigations and hearings by the Interstate Commerce Commission came to be regarded as mere preliminary proceedings in the adjudication of railway disputes by the federal courts. To remedy this situation, in some measure, was the object of the provisions of the Hepburn Act involving changes in procedure and enforcement.

Under the original Act the carriers were at liberty to disregard an order of the Commission, without incurring liability to punishment for violation, until the Commission brought suit and secured a decision of a federal court sustaining its order. The burden of taking measures to make its orders effective was thus thrown upon the Interstate Commerce Commission. Under the Hepburn amendments the orders of the Commission become effective on the date specified by the Commission (being not less than thirty days from the date of their promulgation) and continue in operation for a period not exceeding two

years, unless modified by the Commission, or suspended, or set aside, by a court.

The necessity for action is thus thrown upon the carriers, which must obey the orders of the Commission or suffer punishment for their neglect, until they apply to a court of competent jurisdiction for relief. The Commission is authorized to grant a rehearing, for good cause, after its order has been issued, and to reverse or modify its original order upon such rehearing. Without special permission of the Commission, however, a rehearing does not operate to suspend the enforcement of the order. The penalty of five thousand dollars which is prescribed for each violation of an order of the Commission becomes operative from the date specified by the Commission for compliance with its provisions. Moreover, it was provided that the circuit and district courts of the United States may, on application of the Attorney-General at the request of the Commission, issue writs of mandamus to compel carriers to comply with the provisions of the Act to Regulate Commerce and its amendments.

The provisions of the Expediting Act were made applicable to suits brought to annul orders of the Commission, as well as to all equity proceedings instituted, as just indicated, for the enforcement of the federal statutes relating to common carriers; and it was further provided that appeals from all decrees granting injunctions in any suit must be taken within thirty days from the issue of such decrees, and that in the Supreme Court these appeals must have precedence over all other causes except proceedings of a like character and criminal cases.

In the matter of judicial review the provisions of Hepburn Act, on their face, presented a vague compromise (expressing the policy of Congress in uncertain

terms) between the demands of the conservative adherents of a broad review by the courts and the more radical advocates of narrow review. The conservatives desired the situation as it developed under the original Act to be continued, thereby retaining the most effective powers of railway control in the courts rather than in the Commission. The radicals desired the right of judicial review to be limited to questions of law, reserving to the courts only the authority of passing upon the constitutionality of the various statutory enactments and administrative orders and the right of restraining the Commission from acting beyond the scope of the powers conferred upon it. The result was a compromise, the real meaning and significance of which was itself determined by subsequent judicial interpretation and enforcement.

Provision was made for judicial proceedings to enjoin, set aside, annul, or suspend the orders of the Commission, but no direct or conclusive declaration was included as to the grounds upon which the courts were authorized to review such orders. On this basis it was provided that upon application for an injunction to enforce an order of the Commission (other than for the payment of money), the circuit court is authorized to issue a writ if it appears that an order "regularly made and duly served" has been violated. The exact meaning of the phrase "regularly made and duly served" was left for judicial determination. The provision, however, that no injunction might be issued restraining the enforcement of an order of the Commission except on a hearing after five days' notice to the Commission has afforded from the outset a substantial protection against frivolous and hasty annulment of the Commission's orders.

In fact, the relationship between the Interstate Commerce Commission and the federal courts since the enactment of the Hepburn amendments, and particularly since 1910, has become greatly improved. There has been a marked tendency on the part of the courts to recognize the supremacy of the Commission as the deliberately selected instrument of federal railway regulation, and increasingly to manifest a disinclination to interfere with the orders of the Commission on economic grounds or considerations of public policy. Soon after the adoption of the legislation of 1906 it was said:

> The fact that an order of the Commission is now effective immediately upon promulgation, and that the carrier must either obey or take steps at once to prevent the accumulation of penalties; that a rehearing before the Commission is provided for; that the duty of the Circuit Court is now to determine the regularity of the order of the Commission; and that no injunction may issue suspending an order without giving the Commission an opportunity to be heard,—all show clearly that Congress has intended to create an efficient administrative board as an arm of the legislative body. It is perfectly clear that the judicial power is expected to interfere only when the order of the Commission is *ultra vires*[27] or unconstitutional.[28]

This estimate of the significance of the provisions of the Hepburn Act introducing changes in procedure and enforcement has been amply justified by subsequent events. The courts, through their own interpretation of the legislative provisions, have unmistakably thrown their weight on the side of a narrow judicial review of the orders of the Interstate Commerce Commission.

[27] That is, beyond the scope of the powers conferred upon it.

[28] Frank H. Dixon, "The Interstate Commerce Act as Amended in 1906," *Quarterly Journal of Economics*, 1906, 22-51.

The Mann-Elkins Act

The Mann-Elkins Act of June 18, 1910, introduced the final important amendatory and supplementary provisions to the Act to Regulate Commerce. The Commerce Court, which was established by this legislation as a means of further expediting the adjudication of railway disputes and of further improving the relationship between the Interstate Commerce Commission and the courts, has since been abolished and hence possesses at this time a mere historical interest. Our discussion of the Mann-Elkins Act, therefore, will be limited to a very brief consideration of its other important provisions—dealing primarily with the extension of the Commission's jurisdiction, the suspension of rate advances, and the new long-and-short-haul clause.

Further extension of the commission's jurisdiction

The application of the Act to Regulate Commerce and the jurisdiction of the Interstate Commerce Commission were further extended to telephone and telegraph companies, whether operated by wire or wireless, and to cable lines, engaged in sending messages from one state, territory, or district of the United States to any other state, territory, or district of the United States or to any foreign country. It was specifically added that the provisions of the Act are not to apply to the transmission of messages by telephone, telegraph, or cable wholly within one state and not transmitted to or from a foreign country from or to any state or territory. Those engaged in the transportation of intelligence by electricity were thus declared to be common carriers, and all of the more

important interstate utilities were thereby brought under the control of the federal government.[29]

SUSPENSION OF RATE ADVANCES

The rate-making powers of the Interstate Commerce Commission, expressly delegated by Congress in 1906 and promptly exercised by the Commission, were further augmented in the legislation of 1910 by vesting in the Commission the authority to suspend rate advances. When new rates, regulations, practices, or classifications are filed with the Commission, it is authorized, either on complaint or on its own motion, to enter upon an investigation as to their reasonableness, and, pending such investigation, to suspend their operation for a period not exceeding one hundred and twenty days beyond the time when such rates, regulations, practices, or classifications would otherwise go into effect. Moreover, if the Commission's hearing and investigation cannot be concluded within the original period of suspension (that is, within one hundred and twenty days), it is authorized to extend the time of suspension for a further period not exceeding six months. In all such rate advances, the burden of proof to show that the increased rates or proposed increased rates are just and reasonable is placed upon the common carrier. Under these provisions of the Mann-Elkins Act the notable rate advance cases of 1910 and

[29] The first section of the Act was also amended by adding the provision that it is the duty of common carriers to establish and observe just and reasonable classifications, and rules and regulations affecting rates, the issuance of tickets, receipts, bills of lading, and the handling of freight and baggage. Prior to the passage of the Mann-Elkins Act the Interstate Commerce Commission had been granted no express authority over classifications, though in practice it had uniformly exercised such authority as part of the rate-making power.

of 1913 were heard and decided, as well as the more recent petitions of the railways arising from the commercial and industrial readjustments incident to the European war of 1914.[30]

THE NEW LONG-AND-SHORT-HAUL CLAUSE

We saw that the effectiveness of the original fourth section of the Act was destroyed by judicial interpretation.[31] A lower rate for a longer than for a shorter haul under substantially similar circumstances and conditions had been prohibited; and the Commission for a period of ten years had permitted carriers to depart from the long-and-short-haul principle only if water competition, or competition of railways not subject to the Act to Regulate Commerce, existed at the more distant point. In 1897, however, by the decision of the Supreme Court in the Alabama Midland Case, it was held that the mere existence of railway competition (whether or not the railways involved were subject to federal control) constituted such dissimilarity of circumstances and conditions as to remove the case from the prohibition of the fourth section. From 1897 to 1910, therefore, the railways were virtually free to disregard the long-and-short-

[30] The legislation of 1910 also included two minor rate provisions which may be here mentioned. (1) The Commission was authorized to fix rates after a hearing held without complaint, on its own motion, being empowered, when it has instituted an inquiry on its own motion, to proceed with the same and issue such orders as it may deem necessary, just as if complaint had been previously made. (2) It was provided that, upon written request to any station agent, a carrier must give within a reasonable time a written statement as to the rate or charge applicable to a described shipment, a penalty of two hundred and fifty dollars being imposed upon the carrier if damage results from a refusal to submit such statement or from any error therein.

[31] See *supra*, pp. 134-137.

haul principle at will; and the authority of the Interstate Commerce Commission over this important and persistent form of local discrimination was judicially nullified.

The amended long-and-short-haul clause of the Mann-Elkins Act, then, constituted one of the most significant provisions of the 1910 legislation. The phrase "under substantially similar circumstances and conditions" was entirely stricken from the section. Common carriers were thus prohibited to charge or receive any greater compensation for the transportation of passengers, or of a like kind of property, for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance, under any circumstances, without the prior authorization of the Interstate Commerce Commission. The chief source of defect in the original fourth section being removed, the long-and-short-haul clause was entirely rehabilitated. Under this new clause the so-called intermountain rate cases, involving a comprehensive readjustment of transcontinental freight rates, were heard and decided, and the Interstate Commerce Commission is proceeding gradually to remove the many anomalies of the southern rate situation.[32]

Conclusion

We have traced the development of the American system of state and federal control, and have examined the

[32] Two other changes in the fourth section may be here noted. (1) Common carriers were prohibited to charge a greater compensation as a through rate than the aggregate of the intermediate rates over the same line or route; (2) railroads reducing rates because of water competition were prohibited to raise them again unless, after a hearing by the Interstate Commerce Commission, it is found that the proposed increase is justified by changed conditions other than the elimination of water competition.

various elements which compose its structure. In the course of its growth, the principles and practices of railway regulation have gradually accommodated themselves to our ever-changing social, commercial, and industrial conditions.

There emerge, however, certain broad tangible results which have become permanently incorporated in our policy of public control of railway enterprise. They are grounded in the whole of American railway experience. The railway business is public in character and intimately concerns the general welfare, so that both the right and the need of governmental control can no longer be disputed. To a large extent, nevertheless, the public interest can be secured only through honest and willing co-operation between the railways and the people. For the certain and adequate accomplishment of the ends in view, however, even with the aid of the mutual confidence and good will of the public and the public service corporations, the expert and continuous supervision of administrative commissions is necessary. Finally, since the railway service is national in scope and influence, being coextensive with the national development of commerce and industry, the supremacy of the federal government in railway regulation must be vigorously safeguarded and uniformly maintained.

TEST QUESTIONS

1. Trace the chief causes of federal legislation and explain their significance.

2. Indicate the general character of federal regulation, explaining its main purposes and describing the important provisions through which these purposes are sought to be accomplished.

3. Compare the essential features of legislative, judicial, and administrative railway rate control. State the functions of the legislature and the courts in the present system of federal railway regulation.

4. Describe the organization of the Interstate Commerce Commission and indicate the extent of its jurisdiction under the original Act to Regulate Commerce.

5. What were the chief provisions of the Act to Regulate Commerce with regard to rate reasonableness, discriminatory practices, and publicity requirements?

6. State the important investigating powers of the Interstate Commerce Commission. What were the main provisions of the original Act as to procedure and enforcement?

7. Enumerate the leading provisions of the Elkins Act of 1903 and explain the significance of each.

8. Why is it said that the Hepburn Amendments of 1906 mark the rejuvenation of the Interstate Commerce Commission?

9. Describe the provisions of the Hepburn Act with regard to discriminatory practices and rate-making power. Explain the importance of the provisions introducing changes in procedure and enforcement and indicate the nature of these changes.

10. Explain the character of the powers vested in the Commission by the 1906 legislation resulting in the strict supervision of accounting practices.

11. Name and describe the leading features of the Mann-Elkins Act of 1910.

12. What are the main provisions of the fourth section as amended by the 1910 legislation?

13. What three things are fundamentally essential for the safeguarding of the public interest in connection with railway enterprise?

14. Trace the development of the rate-making powers of the Interstate Commerce Commission.

15. State the chief causes of the enactment of the Hepburn Amendments of 1906 and the Mann-Elkins Act of 1910.

16. Enumerate the various utilities over which the Interstate Commerce Commission now has jurisdiction.

NOTE ON SOURCE MATERIAL

The publications of the Interstate Commerce Commission constitute the most important source material on American railway transportation. In addition to occasional documents resulting from special investigations, these publications consist of the Commission's decisions (thirty-two volumes at the present time), its annual reports to Congress, and the *Statistics of Railways in the United States* prepared each year under its supervision. The decisions and reports of the state railroad and public service commissions afford similar source material. The decisions of the California, New York, and Wisconsin commissions are especially important. The judicial records and decisions of important cases coming before the courts, state and federal, on appeal from the orders of the Interstate Commerce Commission and of the state commissions present the best evidence of the relationship between the legal and economic problems involved in railway regulation. The *Report of the United States Industrial Commission* (1902), Vols. IV, IX, and XIX, contains a mass of valuable material on American railway conditions prior to 1900. The Windom Committee investigation of 1874 (U. S.) and the Hepburn Committee investigation of 1878 (N. Y.), as well as the special Congressional hearings incident to the enactment of the more important federal laws, in 1887, 1903, 1906, and 1910, have made available a large quantity of first-hand testimony covering the entire field of railway economics and government regulation of the transportation industries.

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